BANKING
MADE-EASY

BEING A COLLECTION OF IMPORTANT
EXAMINATION QUESTIONS AND
ANSWERS FOR I. COM. AND
B COM. CLASSES

By

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NOTE

The book now contains all the important questions and answers of most of the Indian Universitie set at I. Com., B. Com., and B. A. examinations. I is, therefore, hoped that the book will be the bes examination guide for the students.

ALLAHABAD }
March 10, 1944. }

K. N.

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PART I

MONEY, CURRENCY & EXCHANGE

CHAPTER I

MONEY

[ITS NATURE AND FUNCTIONS—QUALITIES F A MONEY MATERIAL.]

Q. 1. Define money, and consider its nature und functions in the economic organization of a ommunity. (*U. P. 1938*)

A. **Definition.** Some writers have defined noney in a very narrow sense so as to include nly metallic coins. Others interpret it in a much vider sense, and include all media of exchange—ıetallic money, paper notes, cheques, bills of :change, and drafts, etc. Modern economists, owever, adopt the midway and include only ıetallic money, and legal tender notes. The ›llowing definitions illustrate the point :

Definition in three different ways.

"Money is a commodity which is used to deote anything which is widely accepted in payıent for goods or in discharge of other kinds of usiness obligation."—ROBERTSON.

Only metallic money included.

As only metallic money is widely accepted, ıs is a definition of the first type.

"Money is purchasing power—something which uys things."—COLE.

All forms included.

As metallic money, notes, and credit instruıents, *e.g.*, cheques, bills of exchange, and drafts, have purchasing power and buy things, this finition includes all of them.

"Money is anything that passes freely from hnd to hand as a medium of exchange and is ıerally received in final discharge of debts."

—ELY.

Only metallic money and legal tender notes included.

Another definition of the same type as above.

"Money includes all those things which a. (at any time and place) generally current without doubt or special enquiry as a means of purchasing commodities and services and of defraying expenses."—MARSHALL.

Metallic money and legal tender notes are the only forms generally acceptable, and hence none but they are included in the term *money* according to these two definitions. When money is defined in this sense it is a synonym to currency.*

Not an end in itself but a means.

Nature. It is now obvious that money is a means by which we exchange our commodities and services for those of others. It is not an end in itself but a means to an end. Nobody except a miser wants it for the sake of its possession but because it has a general purchasing power; it gives to its holder a command over all goods and services. According to Weston, money allows the consumer to take his real income at the time and in the manner that suits him best. It is a certificate that the claims a man has upon the stock of goods will be honoured by the community, whenever he wants it to do so. Besides being a means, it is also a measure which enables us to compare the value of different things. In fact, it is as a measure that money is more important these days. In many cases, we sell commodities and services without getting actual money in exchange. They are only measured in terms of money, and a book entry is made. This, in turn, is cancelled b another entry at a later date. Money also help us in several other ways.

Also a measure.

These days it is more important as a measure.

* If money is taken to mean all media of exchange :—

Metallic money+legal tender notes (currency)+credit Money. Money−credit=currency (metallic money+leg. tender notes).

Functions. The functions of money may be classified into primary, secondary and contingent. Primary functions are, (i) service as a means, and (ii) measure, which have already been discussed previously. The secondary functions are the service as, (i) a store of value, as (ii) a transfer of value, and as (iii) a standard for deferred payments. These functions are dependent upon the primary functions. The contingent functions of money are those of (1) the distribution of social income, (2) the equalisation of marginal utilities, (3) acting as basis of credit, (4) giving a generic form to capital.

Primary functions. Secondary functions. Contingent functions.

Service as a means has, as has already been observed, receded to the background these days due to the universal development of credit system. The second function namely that of acting as a measure of value is, however, the most important even now Our economic life is very complex. It is the use of money as a measure of value of all commodities and services that makes it easy. Most of the troubles of the society have been removed because of this function of money. Coming to the secondary functions, we find that we can store value much more easily in the form of money than in the form of other commodities. Labour (or services) cannot be stored at all; for if we do not work for a moment that much of labour (or service) is lost for ever. We can also transfer value in terms of money with sufficient ease. This helps us a good deal. It serves as a standard for deferred payments as well. These involve a period of time before they are fulfilled. If prices of commodities between this interval rise or fall, the debtor or the creditor, as the case may be, stands to lose. But if these are expressed in

Means. Measure. Store of value. Transfer. Standard for deferred payments.

terms of money, its value being more stable than that of any other commodity, chances of loss are greatly reduced.

Distributor of joint product.

Marginal utilities are equalised.

Large-scale enterprises

Generic form of capital.

Professor Kinley has also described four contingent functions. They are true only of the present economic stage. Firstly, money serves as a distributor of joint product or "national dividend". Division of labour to its utmost limit has been made possible only by this service of money. Nobody would cooperate, if he is not assured of the apportionment of the joint product. Secondly, it also enables a consumer to spend his income on various items of expenses in such a way as to derive equal marginal utility from each of them. Thirdly, the vast superstructure of credit has been raised on the basis of money. Gigantic works have been established. Finally, it enables capital to get a generic value, as it can be kept in the most liquid form and thus helps production.

Q. 2. Define money carefully and discuss its importance in the present-day economic organization.

A. **Definition.** See answer 1, part first.

Indirect and round about satisfaction of wants made possible.

Large-scale production and Division of Labour.

Importance. Money has assumed vast importance in the present day economic organization. One man is now very much dependent upon another. Satisfaction of wants has become indirect and round about. It is, under the circumstances, possible only through money. We produce for market, and on a very large scale. Division of labour and specialisation have become the order of the day. These could not have been possible without the use of money.

Principle of joint-stock enterprise has been introduced only because we have money amongst us. It has given a mobility to capital and leads to its concentration in the hands of those who have got the best ability to employ it. Efficient production requires assemblage of land, labour, capital, and other necessary things. This is done with the help of money.

Mobility of capital.

Assemblage of all factors of production.

Reward of various factors of production is determined in its terms. It is distributed amongst them only when the produce is sold in the market. Money plays a fundamental part in this sale. The old barter economy was characterized with serious shortcomings. They have been removed under money economy. The vast magnitude of internal as well as foreign trade has been made possible only because of the introduction of money.

Short-comings of barter removed.

Internal and external trade facilitated.

One, who has money, commands power over everything. He can satisfy his wants. All the world is prepared to serve him. He can claim at any time and in any manner.

Money is power.

We borrow and lend also through money. Our banking organization and credit system is solely dependent upon it. Floating of loans by Government, public and private bodies and individuals has been made possible through money. The Stock Exchange with its elaborate machinery has come into existence because we have money.

Banking organisation.

Different kinds of loans and stock exchange operations.

It is because of such vast importance of money that a slight disturbance in the monetary system of a country has far-reaching effects upon the people. All of us know that businessmen and governments had to face acute difficulties during the great European War of 1914-18 because of monetary disturbances. In fact, the history

Slight disturbance causes difficulties.

of the currencies of different countries of the world goes to prove the fact. The relation between various classes of people changes, with every change in the value of money. Upon the correct solution of the monetary problems of a country depends the progress of its people. Money is important these days to a very great extent, and forms the nucleus round which all of us muster.

Correct solution of monetary problems necessary.

Q. 3. Trace the evolution of money and discuss its importance in the present-day economic organization. (U. P. 1939.)

A. **Evolution.** In the early stages of economic evolution, barter (direct exchange of commodities for commodities) was in vogue. Production was very much limited and meant for only local exchange. A number of difficulties were experienced under this system. Firstly, there could be no exchange so long as there was no double coincidence. For example, if a man had a cow and wanted a horse, he could not get it unless he found a man who was prepared to give a horse and at the same time was willing to accept his cow in return. But this was not always possible and easy. Much time was often wasted in seeking such a person. Secondly, it was difficult to judge as to how much of one thing was to be exchanged for how much of another. There was a good deal of difference of opinion in fixing the value. Thirdly, certain things could not, by nature be broken or divided, and exchange became difficult when the values of commodities differed. With a view to remove these difficulties some commodity came to be selected as a medium of exchange. The commodity selected was often one in general demand in that particular community.

Barter stage.

Difficulties.

Lack of double coincidence.

No common measure of value.

Indivisibility.

Hence, many commodities have served as money from time to time. Furs, oxen, slaves, shells, skins, cocoa etc., have served in the past as media of exchange. In many villages grain is, even now, used as such for petty purchases in our own country. But on account of their superior advantages, gold and silver have, in course of time, come to be regarded as most suitable media of exchange. Paper money has also been introduced recently. But it is a representative of either gold or silver. When it is not so, its circulation becomes dangerous.

Commodity in general demand chosen.

Gold and silver chosen finally.

Importance of Money. See ans. 2, second part.

Q. 4. Define money carefully. Discuss its functions. Why is it that barter is becoming more and more popular in modern times, particularly after 1930? (U. P. 1940)

A. **Definition and Functions.** See ans. 1.

Causes of the popularity of barter in modern times, particularly after 1930. Since the Great European War of 1914-18, attempts have been made to lessen the use of gold in internal as well as external trade. In external trade even before the war it was said that exports pay for imports. After the war it became more true, as there being no gold left in Germany and certain other European countries, imports were restricted to the amount of exports. If there was any excess it could not be paid in gold. Even countries having gold with them built high tariffs against imports. Geneva Conference of 1927, however, recommended to put a stop to the growth of customs tariffs. For a brief period, the report of this con-

Exports pay for imports.

After war gold not available even for paying for excess imports.

High tariffs built.

ference did have some effect in checking the growth of higher tariffs and even in winning some minor successes towards breaking down the barriers to international trade. But U. S. A. swung the world in the pernicious path of ever higher and wider tariffs by the example and effect of its Hawley-Smoot Tariff of 1930. Just a little after, Great Britain levied high import duties. Then, general tariff increases were made by one country after another, and in some of them again and again. Not only that, but more drastic measure of stopping imports were introduced, such as the prohibition of imports except under the license or the definite limitation of imports to a specified quota. By the spring of 1933, France had quotas applying to over 12,000 tariff items. Many countries introduced exchange control whereby importers were unable to offer money for foreign goods. The hindrance to trade of countries with controlled exchanges was so serious that eventually a considerable number of clearing arrangements developed. The last device of the period was the setting up of Exchange Equalisation Funds. At present, there is nothing but barter, in international trade, with this difference that it is a refined barter—a barter where money does not act as a medium of exchange but acts as a measure of value. Between different countries of the world there is exchange of goods with goods. If a country exports more than what it imports, its excess exports are to be carried forward for being cancelled by excess imports.

Hawley-Smoot Tariff of 1930 in U. S. A.

Britain followed. Other countries.

France.

Exchange Equalisation Funds.

Exchange of goods with goods between two countries.

Q. 5. Explain what you mean by money. Discuss the advantages of money to the consumer, to the producer, and to the economic system generally. (Calcutta, 1940)

A. **Meaning of Money.** See definition, ans. 1.

Advantages to consumer. First of all, a consumer can arrange the items of his expenditure in order of his utility which is measured with the measuring rod of money. This enables him to derive equi-marginal utilities from all the commodities and services. Secondly, it enables him to command everything in this world. What to say of common articles and services, he can have to some extent health, love, pity, respect and peace as well. They are all bought and sold in markets.

Possibilities of getting equi-marginal utilities.

He can have everything at his command.

Advantages to producer. A producer can take the help of other producers. He can buy raw material, hire labourers and have all he needs in production. Partnership, joint stock and other enterprises have come in vogue only because of the use of money. Modern large scale production and division of labour are also the results of the introduction of money. Besides, it has given a generic form to capital which, in fact, is responsible for bringing about the present advancement in society.

Four advantages

Advantages to the economic system generally. Money has been advantageous to the economic system generally by providing it with a measuring rod. It is as necessary for exchanges, as numbers are for calculations; feet and inches, etc. for measure; pounds and seers, etc. for weight; and language for expression. Besides, it acts as a store of value, a transfer of value and a standard for deferred payments; and these are the essentials of the present day economic organisation.

It acts as a measuring rod, and helps in various other ways,

Q. 6. (a) Carefully define 'money' and discuss its importance.

(b) Can a commodity serve as a medium of exchange without being a measure of value and vice versa? Give examples. (Allahabad, 1943).

A. **Definitions of money.** See answer 1, first part.

Importance of money. See answer 2, second part.

B. A commodity can serve as a medium of exchange without being a measure of value and *vice versa.* For example, we may take paper and gold bullion. We know that the former in

Paper money

the form of notes, bills and cheques passes as a medium of exchange without being a measure of value. Its intrinsic worth being almost nothing, it cannot act as a measure of value. The latter, however, does not pass current under a gold bullion standard or a gold exchange

Gold bullion

standard; but acts as a measure of value, the value of the currency in circulation being fixed in its terms.

Q. 7. Discuss the defect of barter, and explain the advantages which have accrued to the society as a result of adoption of money economy.

A. **Defects of barter.** See under the heading *difficulties of barter* in answer 3.

Advantages to society as a result of adoption of money Economy. See under the heading *Importance*, in answer 2.

Q. 8. Consider the merits and defects of gold

as money and show how far it is superior to silver in this respect. (*U. P. 1936*)

4. ***Essential properties of a money material.*** *There are certain very important properties which an article must possess in order to serve as a money material.* These may be enumerated here in order of their importance as follows:—(1) utility and value, (2) portability, (3) indestructibility, (4) homogeneity, (5) divisibility, (6) stability of value, (7) cognizability, and (8) malleability.

They are eight in number.

Gold possesses all these properties to the most. Gold possesses all these properties, if taken together, to the most. It is possible that any one of these properties may be found in a larger degree in any other commodity. All of them will, however, be not found together to an equivalent degree in any other commodity.

In respects of stability of value and portability it is preferable even to silver.

Stability of value. Value of gold is comparatively stable. While the price of silver fell from 60-7/8*d*. an ounce to 22*d*. an ounce only during the last three decades of the nineteenth century that of gold remained at £3.17.10½ an ounce during the whole of the century. It was mainly on this account that almost all the important countries of the world gave preference to gold over silver as money material. The reasons why the value of gold is comparatively stable are its indestructibility and portability and the fact that its cost of production is high. On account of the indestructibility of gold its stock is comparatively very large in proportion to its annual production, and, therefore, any amount which is added annually to the exist-

Great fall in the price of silver within a few decades. But stability of gold throughout the century. Stability due to high cost of production and indestructibility and portability.

ing stock does not affect its supply to the extent of affecting its value. The amount of gold available every year is again limited by its scarcity, and the cost involved in producing it is fairly high, which places a check upon a violent increase in its supply. Silver lacks in portability and its cost of production is comparatively low. It was perhaps on these accounts that it so much fluctuated in value. Gold has, however, recently fluctuated very much. But this is because it has accumulated in the hands of only one country which has arbitrarily fixed its price at a particular figure. In fact, this is so because the natural flow of gold has been checked.

Portability. As commerce became world-wide and the market for most commodities became as wide as the whole world, it was felt that the medium of exchange should be easily portable. For this purpose, it must contain high value in small bulk. Gold is, in this respect too, better than silver.

High value in small bulk.

Material progress under gold standard. There was a good deal of material progress during the period gold acted as money. Its stability and portability brought about the development of international trade to an increasing extent resulting in efficient production. Since it has ceased to function as a standard for money, the progress of international trade has been very much retarded.

Defects. Gold, being scarce, cannot be adopted by all the nations of the world as their standard. First of all, plans were devised to economise its use by adopting its modified forms known as the Gold Bullion and Gold Exchange Standards. But these could also not be continued

Scarcity.

for long. It so happened during and after the Great European War of 1914-18 that a considerable portion of the whole stock of gold came to be concentrated in the hands of only a few countries. As a result of this, others had to take up to paper standard. Later on, even those countries which had sufficient gold with them had to demonetise it in order to keep their currency according to trade requirements and not let it be increased with an increase in their stock of gold. The one greatest defect of linking currency with gold is that it expands and contracts according to the supply of gold and not according to the needs of commerce, and gold is not available according to the requirements. In fact, this has been the reason of its failure to continue to be a monetary standard of the world.

Centralised in a few hands.

Volume of currency dependent upon supply of gold, not upon requirements.

APPENDICES

I

SHORT NOTES

Free Coinage. Coinage is said to be free if public is allowed to offer bullion for being converted into coins. It is not necessary that free coinage should also be gratuitous coinage. In case it is so, it is known as *Free and Gratuitous Coinage.* If, on the other hand, some charge is made for coinage, it is said to be *Free and non-Gratuitous Coinage.* In case, however, mint is open only to the government, it is known as *limited coinage.*

Seigniorage. In case minting authority charges a fee more than the cost of minting, the difference between the charge taken and that actually incurred in minting is known as seig-

niorage. There is a very heavy seigniorage on rupee. If, however, the charge is limited only to the expense actually incurred, it is known as *brassage.*

Debasement. When currency contains less than the declared amount of precious metal the difference is called debasement. It may be due to (1) the dishonesty of the minting authority, or (2) that of the people who take out a portion of the metal from the coin by means of either *abrasion or clipping* or *sweating.*

Token money. If face value of money is more than its intrinsic value it is known as token money. Paper notes are all token money; metallic currency in India is also token money.

Legal tender money. If payment is enforceable in a particular form of money, it is known as legal tender money. Cheques are not legal tender money. Their acceptance in settlement of a debt is not compulsory. On the other hand, notes and coins are legal tender money and they must be accepted as such. Some forms of money are *full legal tender* or *unlimited legal tender*, while others are *limited legal tender.* Rupees coins are unlimited legal tender, as payment can be enforced in them to any extent. Four anna bits, two anna bits and other coins of small denominations are limited legal tender, *i. e.*, payment can be enforced in them only to a limited extent, *viz.*, upto rupee one only.

Standard coins. Coins to be standard must have certain specialities: (1) they must be full-bodied coins, *i. e.*, their metallic value should be the same, as their face value, (2) mint should be

open to the public for their free coinage, (3) they must be unlimited legal tender, and (4) they should be the principal money of account—the value of all other coins must be a fraction of the same. British sovereign was a standard coin. Indian rupee was also a standard coin till 1893.

Token coins : These are the coins (1) whose metallic value is less than face value, (2) which are limited legal tender, (3) for whose coinage mint is not open to the public, and (4) which are subsidiary to the principal coin or money of account.

II

Supplementary Questions

1. Define money. What functions are performed by money at the present time ? (*Delhi*)

Please consult answer to question No. 1 on this topic.

2. What are the characteristics of a good money material ? (*Delhi*).

Please consult first paragraph of answer to question No. 4. These shall have to be discussed.

CHAPTER II

MEANING OF MONETARY STANDARDS

[GOLD STANDARD; BI-METALLISM, GOLD EXCHANGE STANDARD AND GOLD BULLION STANDARD, OTHER STANDARDS.]

Q. 9. What do you understand by a Gold Bullion Standard? How does it differ from Gold and Gold Exchange Standards and what are its merits over them? (U. P.—1936)

Gold is a measure of value, not a medium.

A. **Gold Bullion Standard.** Gold Bullion Standard is a modified form of Gold Standard first adopted by great Britain in 1926. Under this system while gold is the measure of value, it no longer circulates as coins. It is a gold standard without a gold currency. The Government, herein, does not issue gold coins, but binds itself to purchase and sell gold bullion in exchange for internal currency, which may consist of paper money and coins of baser metals at fixed rates. This provides a true link between the circulating media and gold between which the maintenance of a permanent ratio is ensured for ever. Exports and imports of gold are also allowed without any restriction whatsoever. The example of Great Britain was later on followed by several other countries.

This system is different from Gold Currency and Gold Exchange Standards.

Gold Currency Standard. Under Gold currency standard gold coins are in actual circulation, and every other circulating media is exchangeable with it. Mint is open for its free coinage to the public and its exports and imports are allowed without restriction. Pre-war gold standard was a standard of this type.

Gold is both a medium and a measure.

Gold Exchange Standard. Gold Exchange Standard resembles Gold Bullion Standard in many points. Under it also, the circulating media does not consist of gold currency. It may consist of paper money and coins of other metals. This currency is exchangeable with gold for delivery in a foreign country. The one essential difference, therefore, between this standard and the Gold Bullion Standard is that while under the latter, currency and gold bullion are exchangeable for delivery within the country, they are exchangeable under the former only for delivery of gold outside the country. In this case gold stocks need not be kept; maintenance of sufficient balances with foreign banks serves the purpose. This system was first adopted by Holland in 1877. Austria-Hungary, India and several other countries adopted it later on.

Currency exchangeable with gold for delivery outside the country.

Merits of Gold Bullion Standard over Gold Currency Standard. Gold Bullion Standard has certain merits over both Gold Currency Standard and Gold Exchange Standard. Let us compare it with Gold Currency Standard first. As pointed out by R. G. Hawtrey, "Gold coin is in fact an imperfect application of the gold standard Its use leads to uncertainty and variation in its nominal gold value through the imperfection and the wear and tear of coins." Gold

Under gold currency each coin varies in weight.

Gold Bullion secures economy of various kinds.

Bullion Standard, on the other hand, is also economical, firstly, inasmuch as the cost of minting the coins is saved, secondly, because there is no loss due to wear and tear, and finally, because under this system a lesser quantity of gold is required by each country than under Gold Currency Standard. It is also obvious that due to the above fact, a larger number of countries can adopt gold standard of this type than that of the Gold Currency type. The quantity of gold thus saved by each nation also yields to it an income from investment. Over and above all, it is also a decided fact that gold in reserve is more useful for stabilization of exchanges than gold in circulation. It was due to these merits of Gold Bullion Standard over Gold Currency Standard that U. K. adopted it in the post-war period.

More countries can adopt gold standard.

Income from investment.

Greater strength for exchange.

Secures confidence and provides for investment habits.

Its merits over Gold Exchange Standard. Though Gold Exchange Standard possesses all the above advantages of Gold Bullion Standard, it falls short of it in respect of confidence. This in itself is awfully deplorable as it checks the development of banking and investment habits. All the savings, under the circumstances, are hoarded in the shape of precious metals. As a result of this, production suffers from the lack of the supply of capital, or else the resources of the country are exploited by the foreigners. Conditions in our own country can be cited as an illustration.

Q. 10. What are the essential features of a pucca bi-metallic system? Why did it break down in the past? Is there any possibility of its revival even in a modified form? (U. P. 1937)

A. **Essential features.** The essential fea-

tures of a pucca or complete bi-metallic system or Double Standard are three in number: (1) Free coinage of both gold and silver, (2) unlimited legal tender characteristic of both gold and silver coins, and (3) a fixed legal ratio between them.

Three characteristics.

Why did it break down in the past? The system broke down in the past because a fixed legal ratio could not be maintained between gold and silver coins for any considerable period, due to variations in their relative value as bullion in the market, where they exchange for each other like ordinary commodities. The divergence between the two ratios led to the operation of the Gresham's law and the overvalued metal drove the under-valued from circulation. In practice, therefore, one metal formed the greater proportion of the circulating media of exchange, as is shown by the currency history of bi-metallic countries. Let us, first of all, take the United States of America which adopted bi-metallism in the last decade of the eighteenth century at the ratio of 15 : 1. With the change of ratio in the market to 15½ : 1 the over-valued silver began to drive the under-valued gold from circulation. This continued till the mint ratio was changed to 16 : 1. But as this ratio was also different from the market ratio which remained at 15½ : 1, the operation of Gresham's law could not be stopped. It, however, began to work in another direction. As gold had since then become overvalued, it began to drive silver from circulation thence onward. Next, if we look at the history of currency in France—another of the most important bi-metallic countries—we find same things happening there too. Sometimes gold and sometimes silver whichever was over-valued formed

Break-down due to the operation of Gresham's Law.

Illustrations.

Alternating standard.

the main circulating media of the country. Bi-metallism is thus, as has been pointed out by some, an alternating standard.

Lack of international cooperation. National bi-metallism, being out of question due to the operation of Gresham's law, possibilities of an international bi-metallism through international cooperation were exploied at the end of the nineteenth century. Conferences of the important nations of the world were called at Paris, and Brussels in 1878 and 1892 respectively with this end in view. But as these failed the fate of bi-metallism was sealed as it seems for ever. If good sense prevails, and international cooperation is secured, there may be possibilities of its revival in some modified form in future.

Q. 11. What do you understand by Bi-metallism? Under what conditions is it likely to succeed? What are its advantages? (Calcutta, 1937).

Two principal coins.

A. **Meaning of bi-metallism.** Bi-metallism is the term applied to a system of currency wherein there are two principal coins—one of gold and another of silver. Its essentials are :—

Essentials of bimetallism

(1) Free coinage of both.

(2) Unlimited legal tender characteristic of both, And

(3) A fixed legal ratio between them.

Impossibility of the maintenance of a fixed legal ratio between them. The system could not be prevalent for any considerable period in any country due to the impossibility of the maintenance of a fixed legal ratio between them for any considerable length of time because of the

market variations in their relative value as bullion. When one metal becomes cheaper in comparison with the other, Gresham's law in its second phase begins to operate, and overrated coins (coins of cheaper metal) drive underrated coins (coins of dearer metal) out of circulation. The best illustration of this can be had from the currency history of France and U. S. A. when they were on bimetallic standard. In fact, there was in these countries an alternating standard under which sometimes coins of one metal and at others coins of another metal formed the largest portion of the circulating media, according as they were over-rated or under-rated.

Operation of Gresham's law.

Best illustration from the currency history of France and U.S.A.

Alternating standard.

Conditions under which bimetallism can succeed. From the above, it may be concluded that this system can succeed only if there is an automatic check to the operation of the Gresham's law which is again possible only if there is an international bimetallism. In international bimetallism all or most of the countries of the world will fix by law the relative value of the two coins as money. Their relative value as metal will also be fixed in the bullion market of the same world. In this case, when there is a variation in the two values, that is as money and metal, of gold and silver there is a corrective which works automatically through the open mint. If silver as metal depreciates and gold as metal appreciates which is the same thing as silver appreciating and gold depreciating as money—silver coins will be minted into currency and gold coins melted into bullion. This process will go on all over the world on an extensive scale, all or most of the countries having bimetallism. But this will lead to a great increase in the demand for silver to be used as money, thus

Automatic check to the operation of the Gresham's law necessary.

International bimetallism.

Corrective which works automatically.

substantially reducing the supply of silver as metal. On the other hand, by the melting of gold coins, the supply of gold bullion will substantially increase. Thus the diminished supply of silver as metal and the increased supply of gold as metal will raise the value of silver in terms of gold. Therefore, the former depreciation of silver and appreciation of gold, which started the process of minting silver and melting gold will be corrected. The process of correction will continue till the relative value of gold and silver as bullion is brought back to the same position as their relative value as coins. This is known as the compensatory action of bimetallism. This does not operate in national bimetallism because the additional demand of the depreciated metal for purposes of minting and the additional supply of the appreciated metal by melting, being confined to one or few countries, cannot affect the supply of the metals in the world market as much as in the case of international bimetallism where the area, over which the operation of such melting and minting goes on affecting the supply of metals, is practically co-extensive with the area, the whole world, in which the relative value of the metals as bullion is determined.

Compensatory action of bimetallism.

Advantages of bimetallism. Bimetallism and specially the international bimetallism which does away with its only disadvantage, *viz.*, that of the divergence in the mint and market ratios of the two metals has certain advantages. They may be given below :—

upply of ioney qual to emand or it.

(1) Joint supply of both gold and silver will enable the quantity of money based on them to be equal to its requirements.

(2) Their annual joint production will keep pace with the annual progress of the people and thus have a steadying effect on prices.

Steadying effect on prices.

(3) Their common use will lead to the prosperity of silver producing and holding countries as well, which have, for so long, been suffering due to the undue and capricious preference given to gold by human beings for its employment in the form of money.

Prosperity of silver producing and holding countries.

One more advantage was claimed for it which has, however, fallen to the ground since the abandonment of silver standard by China. It was that it will open the markets of this important country for all those adopting this system.

Q. 12. What do you understand by bimetallism? In what way was it expected to solve the currency problems of the world in the last quarter of the nineteenth century?

A. An answer to this question can be given with the help of the answer to Q. No. 10.

Q. 13. 'Gold Bullion Standard not only possesses all the essential features of Gold Currency Standard but it has several advantages over the latter.' Explain fully this statement. (*U. P.* 1937)

A. **Essential features of Gold Currency Standard.** Gold Currency Standard has certain essential features, *e.g.*, (1) Currency in circulation consists of gold, for the free coinage of which mint is open to the public. (2) There is no restriction on the export and import of gold. Gold Bullion Standard also possesses these essential features, with the only difference that the currency does not consist of gold. Instead, it is exchangeable with a fixed quantity of gold. Evidently, it does not matter much whether the currency

Two essential features of gold currency standard.

Gold Bullion Standard possesses the same features with a little difference.

This difference is of no importance.

consists of gold or of something else provided it is exchangeable with gold, as money is not an end in itself but a means to an end, and anything which is exchangeable with goods will serve the same purpose as gold *A pound note purchases*

Illustration.

as much as a sovereign so long as it is exchangeable with sovereign or gold contents of sovereign. From 1926 to 1931 during the regime of Gold Bullion Standard in England a pound note had the same purchasing power as a sovereign or gold contents of a sovereign.

Gold Bullion Standard has certain advantages over Gold Currency Standard: Gold Bullion Standard has some advantages over Gold Currency Standard. (1) Cost of minting is saved—cost of printing notes (the currency which takes the place of gold coins) is lower than that of minting. (2) Loss due to wear and tear of coins is avoided. (3) Gold in reserve is more useful for strengthening exchange rate than gold in circulation. (4) Economy of gold—a lesser quantity of gold in reserve against currency is required than that of gold in circulation. (5) Because of the economy of gold, a larger number of countries can adopt gold standard of the Gold Bullion than that of the Gold Currency type. (6) Gold saved can be invested and thus becomes a source of income. But Gold Bullion Standard is good for only those people who have confidence in the authority issuing the currency. This is, however, not possible under foreign rule.

Six points of advantages.

Q. 14. Mention the important differences between the Gold Bullion and Gold Exchange Standards, indicating the merits of each over the other. (U. P. 1938)

A. **Differences.** The following are *the*

Important differences between the Gold Bullion and Gold Exchange Standards :—

Gold Bullion Standard.	**Gold Exchange Standard.**
1. Internal currency is exchangeable with gold for delivery in the country.	*1. Internal currency is exchangeable with gold for delivery out*side the country.
2. Gold reserves are kept in the country.	2. Gold reserves are kept outside the country. Credit balances with foreign banks also serve, if these countries have gold standard.

Advantages of Gold Bullion Standard over Gold Exchange Standard. Gold Bullion Standard has certain obvious advantages over Gold Exchange Standard, inasmuch as people have a greater confidence in currency. They do not hoard gold as they know that they can get it as soon as they have a desire to possess it. This provides a stimulus to investment habit which, in its own turn, helps production. A country with Gold Exchange Standard may lose heavily in case the foreign banks holding its credit balances suspend payment. This, in fact, is the greatest drawback of Gold Exchange Standard.

Confidence.

Stimulus to investment.

No danger of loss.

Q. 15. Explain the difference between the pre-war gold standard and the modified gold standard adopted by most countries in the post-war period. (U. P. 1939)

A. This question can be solved with the help of the answers to the previous questions on this topic.

Q. 16. Distinguish fully between (a) Gold Standard, (b) Gold Bullion Standard, and (c) Gold Exchange Standard. What standard do you have in India at present? **(U. P. 1940.)**

Features of Gold Currency Standard.

A. **Gold Standard.** (*a*) Gold Standard here means Gold Currency Standard, wherein gold acts both as a medium of exchange and as a measure of value. That is, gold is coined freely and coins of gold are standard coins. They circulate. Paper notes, if any, are convertible into them at the option of the holder.

Features of G. B S

Gold Bullion Standard. (*b*) Gold Bullion Standard is a form of gold standard wherein gold is a measure of value and not a medium of exchange. That is gold coins are not coined, and do not circulate. Their place is entirely taken by paper money or token coins of baser metals. These are, however, exchangeable with gold at a fixed rate.

Features of G. E. S.

Gold Exchange Standard. (*c*) Gold Exchange Standard resembles Gold Bullion Standard inasmuch as here also the circulating media does not consist of gold. It consists in the same way of paper money or token coins of baser metals. But these are exchangeable with gold only for foreign delivery. Obviously, under this system, currency is inconvertible except for the purposes of foreign payment.

Neither of the three.

Standard in India. We have got at present none of the above standards in India. Gold coins do not circulate. Nor is the internal currency exchangeable with gold for delivery anywhere. We have, in their stead, what is known as Sterling-exchange Standard. This is a standard wherein internal currency is exchangeable with sterling at

a fixed rate. Sterling is British currency and was formerly exchangeable with gold. So long as this was so there was truly speaking, no difference between Sterling Exchange Standard and Gold Exchange Standard. It is, however, not so at present.

Sterling Exchange Standard.

Q. 17. Explain fully the difference between Gold Standard, Gold Bullion Standard, and Gold Exchange Standard. (U. P.—1942)

A. For an answer to this Q., please refer to the answer to Q. No 15.

Q. 18. Explain Gold Exchange Standard, fully discussing its advantages and disadvantages. Do you think that the world should adopt it after the present war as a part of the monetary reconstruction scheme? Give reasons. (U. P. 1943.)

A. **Gold Exchange Standard.** Gold Exchange Standard is a system of currency wherein the circulating media does not consist of gold currency. It may consist of paper money, and coins of other metals than gold. This currency is exchangeable with gold for delivery in a foreign country. In this case, gold stocks may be kept in various foreign countries or only bank balances may be maintained in them provided they are prepared to offer gold in case of need. This system was first adopted by Holland in 1877 and then by Russia and Austria-Hungary in 1892 India* and several other countries adopted it later on. Besides, this was the standard which was adopted after the war of 1914-18 by those countries of central Europe whose currencies

Circulating media does not consist of gold currency.

Exchangeable with gold for delivery in a foreign country.

Gold stock or bank balances held in foreign countries

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*But India was the only country which adopted it in a complete form.

Its importance.

had to be entirely reconstituted due to their bottomless depreciation. In fact, it was recommended at the Genoa Conference of 1922, and its fundamental principles may be said to have affected all monetary systems during the last twenty years.

Economical in various ways.

Advantages. (1) This standard has the advantage of being an economical standard. Paper money and coins of other metals than gold, which are in circulation in this case, provide cheap currency. In their case, loss due to wear and tear is almost negligible. There is bound to be some saving in the cost of printing and minting as well. Finally, a lesser quantity of gold is required by each country under this standard than under gold currency or gold bullion standard.

Gold standard of this type can be adopted by a larger number of countries.

(2) It is also obvious that due to the limited requirement of gold by each country, a larger number of countries can adopt gold standard of this type than of the gold currency or gold bullion type.

Income from investment.

(3) The quantity saved by each country yields an income from investment.

Gold currency is an imperfect application of gold standard.

(4) 'Gold coin is, in fact, an imperfect application of the gold standard. Its use leads to uncertainty and variation in its nominal gold value through the imperfections and wear and tear of coins' Hence, gold exchange standard is advantageous over gold currency standard from this point of view as well.

Gold available for the stabilisation of exchanges.

(5) Under gold currency standard, gold being in use may not be available for the stabilisation of exchanges. But under gold exchange standard, it will be so. This is, therefore, an extra advantage of the latter standard over the former.

Disadvantages. (1) Gold exchange standard forms short of both the gold currency standard and gold bullion standard as far as the question of confidence is concerned. Lacking in confidence.

(2) As a result of the above fact, it checks the development of banking and investment habits. All the savings, under the circumstances, are hoarded in the shape of precious metals. Checks development of banking and investment habits.

(3) As a consequence of the above, production suffers from the lack of the supply of capital, or else the resources of the country are exploited by foreigners. Conditions in our own country can be cited as an illustration. Loss of production.

(4) Gold exchange standard is not automatic. Under an automatic system of currency, e.g., (1) gold currency standard, when gold in circulation is in excess of the needs of trade, excess gold in circulation is melted down or exported, and (2) gold bullion standard, when currency in circulation is in excess of gold, it is tendered to the Government and gold obtained instead. Under gold exchange standard also, it may be supposed that currency in circulation would be reduced when it is tendered in exchange for the delivery of gold in a foreign country. But it depends on the will of the Government which may reduce the currency by the full amount of the gold sold or by a smaller amount. This was the case in India, during the regime of gold exchange standard as is evident from the Report of the Indian Currency Commission 1925 which refers to the 'absence of contraction on occasions when the currency authority has had to sell sterling exchange.' It is not automatic.

(5) Gold exchange standard is not elastic, *i.e.*,

it does not make a provision for an increase in currency in busy seasons and times of financial crisis. It is inelastic. *When crops have been harvested and are* moved, there arises an increased demand for currency which can, however, be not ordinarily met without their being exported. No doubt a remedy lies in the increase of credit instruments and paper money on their basis.

Adoption of the gold exchange standard as a part of the monetary reconstruction scheme after the present war. A huge amount of money is being spent up during the present war by almost every country and this is made possible only by an unlimited issue of notes which are surely inconvertible at least for the time being though they cannot remain so for ever. After the cessation of hostilities, international trade must develop and this requires the world currencies to be based on something concrete. No doubt, several schemes of currency management without the use of gold have also been suggested from time to time. But they have their own limitations, and it can be said with certainty that the basis of future monetary structure must remain gold. The preference of the public for it is deeply rooted. The question is, however, what form this basis will take. Of course, it cannot be the gold currency form. The only alternatives are then gold bullion and gold exchange forms. Of these gold bullion form is, as we know, preferable to gold exchange form specially if we take the point of confidence in view. Hence, it may be concluded that the adoption of the gold exchange standard as a part of the monetary reconstruction scheme after the present war is just possible. Some of the coun-

Notes are inconvertible at present.

Basis of future monetary structure must remain gold.

tries may adopt gold bullion standard but all cannot do so. They shall have to be content with gold exchange standard *only.* **Gold Exchange Standard possible.**

Q. 19. What is the difference between (i) gold bullion standard and gold standard with gold coin in circulation; (ii) gold exchange standard and gold standard? (Allahabad 1941)

A. (i) Differences between gold bullion standard and gold standard with gold coin in circulation.

Gold Bullion Standard	*Gold Standard*
(1) Gold coins do not circulate.	(1) Gold coins circulate.
(2) Internal currency consists of paper notes or coins of some other metal than gold.	(2) Internal currency consists of gold coins or paper money convertible into gold coins.
(3) Internal currency is convertible into gold bullion.	(3) Internal currency consists of gold coins or paper money convertible into gold coins.
(4) Gold is only a measure of value and not a medium of exchange.	(4) Gold is both a measure of value and a medium of exchange.

(ii) Differences between gold exchange standard and gold standard.

Gold Exchange Standard	*Gold Standard.*
(1) Gold coins do not circulate.	(1) Gold coins circulate.
(2) Internal currency consists of paper money and coins of some	(2) Internal currency consists of gold coins and paper notes con-

metal other than gold.	vertible into gold coins.
(3) Internal currency is convertible into gold for foreign delivery.	(3) Internal currency consists of gold coins and paper notes convertible into gold coins.
(4) Gold is only a measure of value and specially for foreign transactions and not a medium of exchange.	(4) Gold is both a measure of value and a medium of exchange.

APPENDICES

I

SHORT NOTES

Limping Standard. It is an imperfect form of bimetallism. Under a limping standard, two metals are unlimited legal tender but only the dearer metal has free coinage. It existed in France and U. S. A. before the war. In these countries both gold and silver coins were unlimited legal tender but only gold coins had a free coinage. Silver was over-rated, and hence under a perfect bi-metallic standard, where mints would have been opened for its free coinage also, it would have driven gold coins out of circulation. So in order to check the operation of the Gresham's law, it became necessary to close the mints for its free coinage.

Mint Price. It is the price which mint is prepared to give for a fixed quantity of gold under gold standard, and of silver, under silver standard, in terms of the currency. British Mint, before Britain went off the gold standard gave for 1

standard ounce of gold £3-17-10½d. Similarly, Indian Mint was prepared during the years 1927-31 to give for gold, in the form of bars containing not less than 40 tolas, Indian currency at the rate of Rs. 21-3-10 per tola of fine gold.

Devaluation. It is lowering down the metallic contents of the currency in circulation. In case it consists of only paper notes, it means lowering down its value in metal or foreign currency. If rupee were to be valued at 1s. 4d. instead of 1s. 6d., it would mean devaluation of rupee.

Parallel Standard. Whenever it is thought desirable to keep gold and silver coins permanently in circulation side by side, their value in terms of each other is not fixed by the mint authorities. It fluctuates according to the conditions in the market. This sort of standard is known as Parallel Standard. England had this standard from 1663 to 1816. There is, however, a serious shortcoming of this standard, *viz.*, people have to find out the value of one coin in terms of another from the market.

Dollar-Exchange Standard. This is a standard resembling sterling exchange standard with the only difference that the value of the internal currency in this case is fixed in terms of dollar, and it is exchangeable with it. Philipines had this standard before Japanese occupation in the present war.

Paper Currency Standard. This is a standard wherein paper currency circulating in a country is convertible neither with any metal nor with any foreign currency according to law. Its value depends upon its volume We have got

this form of currency at present in a number of countries. Its value is very precarious as it depends upon the will of the issuing authority.

Tabular Standard. In case, the value of inconvertible paper currency in circulation is kept steady in terms of other commodities, it is known as Tabular Standard. Index numbers are prepared and the volume of currency is kept in conformity with them.

Composit legal tender. It is very inconvenient, nay impossible, to have all the coins of gold. Coins of small denominations which are absolutely essential for our everyday small transactions cannot be made of gold, obviously due to their being reduced to an inconvenient size. Hence, along with gold coins which form the principal media of circulation, there are also coins of other metals. These are subsidiary coins and help the principal coins in settling transactions involving fractions. Such coins are minted only on Government account. They have the essentials of token coins. This system of currency is known as the composit legal tender system of currency.

Compensatory action of the double Standard, Consult the lines in connection with this marginal note in answer to Q. 11.

Symetallism. This is a system under which the principal coin is made up of two metals mixed into one. It has never been adopted by any country in practice. This system was originally suggested by Alfred Marshall. It does not, however, possess the necessary quality of being readily intelligible by the ordinary person.

II

SUPPLEMENTARY QUESTIONS

Q. 1. What is bi-metallism? Describe its chief advantages and disadvantages.

A. This question can be solved with the help of the answer to Q. 11.

Q. 2. In what different ways is it possible to combine gold and silver in the currency system of a country. *(Calcutta,* B. A.)

A. In answering this question bi-metallism, limping standard, parallel standard, symetallism, and composit legal tender system shall have to be discussed.

CHAPTER III

GRESHAM'S LAW

Q. 10. State briefly Gresham's Law, indicating the conditions and qualifications under which it operates. Give examples (*U. P. 1938*)

A. **The law.** 'Gresham's Law', according to Marshall, is that an inferior currency, if not limited in amount, will drive out the superior currency.

It seems paradoxical.

But it is not so.

Its operation. At first this seems paradoxical, as people in their self-interest generally choose good things and reject bad ones, but in case of currency they seem to behave differently. But this paradox is easily solved, if we look at the things rather minutely. Good currency and bad currency both have the same value as money within the country, but their value is different as bullion. The owner, under the circumstances, naturally puts the bad currency in circulation for making the payment, so long as it is not refused by others, and withdraws the good which is melted and sold as bullion or hoarded or used in arts or exported in payments to foreign creditors who accept it as bullion.

Conditions. There are three conditions under which it operates :—

Worn out coins drive newly minted coins.

(1) Under monometallism. When old and worn out coins circulate together with newly coined full weight coins, the old and worn out coins (bad currency) drive newly coined full weight coins (good currency) out of circulation.

For example, during the reign of Elizabeth when the mint at the London Tower driven by horses manufactured new coins, they were soon found to have been driven out of circulation by the old coins which were much worn out and depreciated.

(2) Under bi-metallism. When coins of two metals with a fixed legal ratio between them circulate together as standard coins and there is divergence between their mint value and market value in terms of each other, over-rated coins (bad currency) drive under-rated coins (good currency) out of circulation. The best example of this can be had from the currency history of France and U. S. A., when they were on bi-metallic standard. In fact, there was in these countries an alternating standard under which sometimes coins of one metal and at others coins of another metal formed the largest portion of the circulating media, according as they were over-rated or under-rated.

Over-rated coins drive under-rated.

(3) Under depreciated paper currency. When depreciated paper currency and metallic currency circulate together, paper currency (bad currency) drives metallic currency (good currency) out of circulation. A very good example of this is provided in the currency history of European countries during the Great European War of 1914-18. We know that gold sovereigns during this period were driven out of circulation from United Kingdom. The same happened with gold Marks of Germany.

Inconvertible notes drive metallic coins.

Qualifications or limitations. In Marshall's statement of Gresham's Law as given above, there is an important phrase, namely, 'if not limited in amount.' Others have used the phrase, 'other

things being equal' to denote the same idea. The use of either of these phrases indicates that this law like other laws of Economics is true only under certain conditions—two of which are very important. The first is that the supply of currency of both kinds is in excess of the demand. In case this is not so, and the trade is so large and brisk that the whole currency, good and bad, is required or falls short of the requirement, bad currency will not drive good out of circulation. Secondly, public opinion should not be opposed to the use of both good and bad coins at the same time. We know that during the post-war period people being opposed to use depreciated currency, Great Britain had to make it good as soon as possible by stablizing it. Besides, if one of these is limited legal tender, or is not allowed free coinage, the law will not operate.

Both kinds of currency inadequate to meet the demand.

Public opinion.

Limited Coinage or legal tender

APPENDIX

SUPPLEMENTARY QUESTIONS

Q. 1 Comment on the statement: 'Bad money drives good money out of circulation'.

Please refer to the answer to question 19.

Q. 2. 'Bad money drives out good money'.

Explain :—

(*a*) What do you understand by 'bad money' and 'good money';

(*b*) how and in what circumstances bad money drives out good money ? (*Calcutta*, 1938)

A. This question can be answered with the help of Q. 19.

CHAPTER IV

DETERMINATION OF VALUE OF MONEY

Q. 20. State and explain fully the Quantity Theory of Money. Illustrate your answer with suitable examples. (*U.P.* 1937)

A. **The theory in its bald form.** The value of money like that of any other commodity, is determined by its supply in relation to demand. Economists have, however, a distinct theory about it, namely, the Quantity Theory of Money. Stated in its bald form, it is "Other things being equal, value of money varies exactly in inverse proportion to its quantity in circulation." For example, if the quantity of money in circulation is doubled, its value is halved, and if the quantity is halved, its value is doubled. This is, however, not so with the value of other commodities. In their case, though an increase in supply brings about a fall in their value and *vice-versa*, it does not necessarily mean that the change is in an uniform proportion. But in the case of money it means so.

Value of money changes in exact inverse proportion.

Importance of the phrase 'other things being equal'. The phrase 'other things being equal' is very important. It comprises a number of assumptions. These are: (1) that the legal tender money is the only form of money in use, (2) that there is no change in the velocity of circulation of money, (3) that there is no hoarding— the whole of the money is in circulation, (4) that

Six conditions.

all the goods are exchanged through money, (5) that there is no credit system, and (6) that the rate of circulation of goods has also not changed. Over and above these assumptions, it is also taken for granted that there have been no changes in production, rate of exchange and population. These assumptions are, however, not in accordance with the actual facts. In the present dynamic state of society, they cannot be true.

An allowance has been made for all these

Recent enunciation of the theory. Recent writers have, therefore, after making allowance for these facts, enunciated it as follows : "The general level of prices tends to vary directly in proportion with the quantity of money in circulation and its rapidity (*i. e.*, its supply) and inversely with the activity of exchange (*i. e.*, the demand of money) indicated by the number of goods exchanged multiplied by their prices." Here the word 'tends' is very significant. In fact all the economic laws show tendency. They are not exact. The same is the case with this law also.

Professor Irving Fisher's expression.

Its mathematical expression. We have got a mathematical expression of the theory. It is in the form of an equation whose one side represents goods and the other money. Professor Irving Fisher has stated it as follows :

$$PT = MV + M^1 V^1 \text{ or } P = \frac{MV + M^1 V^1}{T}$$

Where P means price-level ; T, the volume of transactions ; M, quantity of money in circulation ; V, velocity of money in circulation ; M^1, quantity of credit money in circulation, and V^1, velocity of credit money in circulation. Here an attempt has been made to explain the meaning of the phrase 'other things being equal' by including the velo-

city of circulation of money, the quantity and velocity of circulation of credit money, the condition of trade and the amount of business done. A change in any of these factors affects the general level of prices.

Professor Chapman has reversed the formula by making P to stand for the purchasing power of money, *e. g.*, $P = \frac{T}{MV + M^{1}V^{1}}$. This is quite correct as the purchasing power of money varies directly with the total of commodities.

Professor Chapman's expression.

Q. 21. Explain the Quantity Theory of Money, and indicate its limitations. (U. P. 1939).

A. **Explanation of the Theory.** Quantity Theory of Money lays down the relation between the general level of prices and the supply of money. In fact, price of every commodity is dependent upon its supply and demand. But in the case of money, it is said that the changes in the supply of money bring about an exactly proportionate inverse change in its purchasing power. This is, however, true provided other things remain the same. These other things are (*i*) rapidity of the circulation of money, (*ii*) total transactions and number of commodities, (*iii*) investment habits of the people, etc. The term money here includes all money—legal tender and otherwise.

Value of money changes in exact inverse proportion.

Three important conditions.

Limitations. But it is not possible for other things to remain the same. We live in a dynamic world where static conditions cannot be found in any sphere. With every change in the supply of money, rapidity of its circulation changes. Even without a change in the supply, rapidity cannot remain the same. Besides, total transactions and number of commodities are subject to fluctuations.

Rapidity of circulation changes.

So is the case with the number of transactions.

In fact, with a change in the supply of money, there is sure to be a change in total transactions and number of commodities. Increased supply of money in itself is a stimulus to production and *vice-versa*. Habits of people too change. Education and travel all develop our outlook.

Change in habits.

The exactness of the theory cannot be tested. We cannot at any time measure the quantity of money in circulation. Nobody can say as to how much of the issued currency has been hoarded or destroyed. The quantity of credit money is still difficult to be measured. Rapidity of circulation can also not be determined with any exactness. Then, the fact as to how many of the transactions have taken place with the help of money and how many without is not possible to be known. The exact number of the goods exchanged and the transactions having taken place too cannot be found.

Its abstractness

Because of all these difficulties, there are many who say that the theory is abstract. Its discussion is of no practical importance. But in fact, this is not so. This theory is of much importance, inasmuch as it tells us at least one of the main reasons of price fluctuations. They can be avoided to a very great extent by controlling the supply of money according to the demand for it. The theory has shown us a path.

It is of practical importance in spite of its shortcomings.

Q. 21 (a). State and explain fully the Quantity Theory of Money and indicate its limitations. *(U. P. 1940)*

A. Refer to previous Qs. on this topic.

Q. 22. The quantity theory of money is a dowdy truism ? Explain the theory carefully, and

examine the view expressed in the quotation. (*Calcutta, 1937*)

A. For explanation of the theory, please refer to answer to Q. No. 21.

The statement—the quantity theory of money is a dowdy truism—is true inasmuch as the theory holds good only under certain limitations which are not included in the wordings of the theory. The limitations are :—

True only under certain conditions.

Note :—Students may state limitations from answer to Q. 21.

Q 23. 'The value of money, like that of other things, depends on the conditions of demand for it and on the quantity of it available.' Discuss. (*Calcutta, 1940*)

A. Refer to previous Qs. on this topic.

Q. 24 Explain the quantity theory of money, and indicate its limitations. (*U. P. 1942*)

A. Refer to previous Qs. on this topic.

Q. 25. State, explain, and criticize the Quantity Theory of money. (*Allahabad, 1943*)

A. Refer to previous Qs. on this topic.

Q. 26. The elasticity of demand for money is equal to unity. Do you agree with this view ? Give reasons for your answer. (*Allahabad, 1942.*)

A. **Explanation of the statement : 'The elasticity of demand for money is equal to unity.'** The elasticity of demand for money is said to be equal to unity when demand for money changes proportionately with a change in its purchasing power. Thus, if purchasing power of money becomes double, the demand for it becomes half; if purchasing power falls by 50 per cent, the

Meaning

Illustration

Total number of commodities remain always the same

demand rises by the same percentage. Here, the total number of commodities purchased always remains the same irrespective of the fluctuations in the purchasing power of money.

Analysis of the quantity Theory of money.

Is the elasticity of demand for money really equal to unity ? In order to answer this question we have to analyse the quantity theory of money. According to this theory, if there are one hundred rupees and one hundred commodities, price of each commodity is equal to rupee one. If, however, the quantity of money is doubled, the number of commodities remaining the same, price is also doubled. Now, in order to say that the elasticity of demand for money is really equal to unity, we may conclude that a rise in prices brings about a proportionate rise in the quantity of money, and there is no variation in the number of commodities. But this is not always so. First of all, a rise in prices does not necessarily mean a rise in the quantity of money as well. The conclusion is wrong. Secondly, number of commodities also does not always remain the same. Usually, a rise in prices is accompanied by an increased production. What is true of the results of a rise in prices is also true of a fall in prices. Hence, we may say that the statement: elasticity of demand for money is equal to unity is not true.

Statement will be True under certain conditions which do not hold good.

Statement is wrong.

Q. 27. Discuss the effects of fluctuations in the value of money on (a) workers, (b) producers, and (c) the state. (*U. P. 1940*)

Fluctuation in the value of money means rise or fall of price level.

A. **Meaning.** Fluctuations in the value of money means rise or fall in its purchasing power. And as the value of money is measured in terms of commodities, it is said to have depreciated if it buys less, and appreciated if it buys more. Rise and fall in prices are inverse to

depreciation and appreciation of money. Let us now examine their effects.

Workers. Rising prices are bad for workers. Their purchasing power is lowered and they are not able to maintain the same standard of living as they used to maintain before the rise. No doubt they try to get higher wages; and they are successful in the long run But during the transition period they have to suffer. Besides, wages do not rise in the same proportion as prices, and hence they suffer to this extent. The harmonious relation existing between the labourers and the capitalists is also adversely affected. There is, however, one thing. Rising prices may bring about reduction in unemployment, and thus improve the condition of the workers as a whole. Falling prices have just the opposite effects.

Standard of living lowered.

Causes bad blood.

Reduction in unemployment.

Producers. Producers gain by rising prices. They find that they can sell their stock at higher prices than they could sell previously. This brings them more profit. But this too is not lasting. The increased income is, in due course, shared by other factors of production also. As demand for land increases, higher rent is to be paid for it. Prices of raw materials also rise. Workers begin to demand more of money wages. Capitalists ask for higher rate of interest. But even after paying to all these, there is a larger gain to the producers as a whole, and so far as they are able to resist the demand of other factors of production for larger remuneration, they are gainers. Generally, producers get a larger share of the increased income than anybody else, and hence they are better off. But there is an evil effect of this also. It is that rising prices act as stimulus to production, and in the end result in accumulation

More profit

Accumulation of unsold stock.

of a good deal of unsold stock Unfair distribution of the increased income curtail the purchasing power of the workers and hence lower down the demand. We know that every boom is followed by depression, failures and ruin of many. Falling prices affect in an opposite direction.

Depression follows.

Revenue increases.

State. The effect of these fluctuations on the State is also very considerable. When there is a gain to producers, State's income too increases. There is an increase in the income tax, excise, and other kinds of taxes. In our own country so far as rising prices give stimulus to production, the State gains in import duties also, as more machines are imported from outside. Then again, there is a gain to the State inasmuch as the spending power of its people rises up. We know that when we spend, we give a portion of it to the State indirectly. Falling prices affect the State adversely.

Q. 28. Define money and show the effects of fluctuations in the value of money on (a) workers, (b) producers, (c) investors, and (d) the state. *(U. P. 1943)*

A. **Definition of Money**—See Q. 1.

Effects on fluctuations in the value of money on *(a)* **workersn,** *(b)* **producers, and** *(d)* **the state**—Refer to Q. 27.

They lose as creditors but gain as producers.

Effects of fluctuations in the value of money on (c) investors. Investors, as a whole lose because money borrowed at a time when it bought more, is paid back at a time when it buys less. Interest payments on the same also become of less value than before. But if they share in profits as proprietors, they gain just as the producers gain.

Q. 29. How will you measure changes in the value of money? Explain the difficulties of such measurement. How will you meet these difficulties? (Calcutta, 1938)

A. **Measurement in the changes of value of money.** Value of money is measured in terms of purchasing power. But the difficulty is that the prices of all goods do not rise or fall at the same time and by the same amount. In order to obviate this difficulty, we adopt the device of striking out an average of the changes in the prices of different commodities and services, and this may take the form of numbers. An average of the prices of commodities at a particular period is also known as price level, and when there are a series of such price levels in the form of numbers, they are known index numbers.

Meaning.

Difficulty.

Averages taken into consideration.

Price-Level and index numbers.

Definition of Index Numbers. Index Numbers may be defined as numbers which represent the prices of a chosen commodity and more usually of a group of commodities at selected dates. They are prepared with a view to compare the prices of the same article or group consisting of certain articles over a given period.

Prepared for the purposes of comparison

Their construction. We start with a base year. This year must be normal. Prices of commodities in this year are taken as equal to 100. Let us suppose that there are four commodities, wheat, rice, sugar, and pulse. Price of one maund of wheat in that year is Rs. 3, that of rice is Rs. 5, that of sugar is Rs. 8, and that of pulse Rs. 4. Let us suppose that next year, prices of wheat, rice, sugar, and pulse become Rs. 4, Rs. 4, Rs. 5, and Rs. 3 respectively. We will tabulate the figures as follows :—

	Base year.	Next year.
Wheat	Rs. 3=100	Rs. 4=133⅓
Rice	Rs. 5=100	Rs. 4=80
Sugar	Rs. 8=100	Rs. 5=62½
Pulse	Rs. 4=100	Rs. 3=75
	4) 400	4) 350 $\frac{5}{6}$
	100	87 $\frac{17}{24}$

Index number in the base year is 100; in the other year, it is 87 $\frac{17}{24}$. Prices have thus fallen or say value of money has risen.

Difficulties of this measurement and remedies. But there are certain difficulties in this measurement, and these can be remedied as follows :—

Base year should be normal.

(1) First of all, there is the difficulty of the selection of the base year. It must be a normal year and not abnormal.

Selection of commodities should be wise.

(2) Secondly, there is the difficulty of the selection of commodities. A fairly large number of representative commodities should be selected. Qualities of these commodities should also not change in subsequent years.

(3) Thirdly, there is the difficulty in the selection of prices. If wholesale prices have been once taken into account, only wholesale prices should be taken into account in other years as well.

Selection of prices.

(4) Difficulties also arise due to the constant shifting of human wants. It has been observed that articles of great importance in one period lose their importance in another period and sometimes cease to be consumed at all. A provision must be made against this as well.

Constant-shifting of human wants.

(5) All articles are not necessarily wanted by everybody and perhaps in the same proportion. Hence, all index numbers do not hold good for all purposes. They must be prepared with a definite object in view, and should take into consideration the points affecting it the most.

Definite object.

Weighted Index Numbers. While preparing index numbers some statisticians give weight to the articles according to their importance. Index numbers so prepared are known as weighted index numbers. Supposing wheat, rice, sugar and pulse are consumed in the ratio of 8, 2, and 1, the Weighted Index Number table will be as follows :—

	Base year.	Next year.
Wheat	$8 \times 100 = 800$	$8 \times 133\frac{1}{3} = 1066\frac{2}{3}$
Rice	$2 \times 100 = 200$	$2 \times 80 = 160$
Sugar	$1 \times 100 = 100$	$1 \times 62\frac{1}{2} = 62\frac{1}{2}$
Pulse	$1 \times 100 = 100$	$1 \times 75 = 75$
	12 12) 1200	12 12) $1364\frac{1}{6}$
	100	$113\frac{49}{72}$

The Weighted Index Number is, therefore $113\frac{49}{72}$.

Q. 30. Explain clearly the effects of inflation and deflation of the currency of a country upon different classes of its people. (*Calcutta, 1937*)

A. **Inflation and deflation.** When supply of money (including credit) relatively to the demand increases to such an extent that prices in general rise and purchasing power of the monetary unit decreases, the currency is said to be inflated. Deflation is just the opposite of inflation.

Meaning.

Effects of inflation or a rise in prices

The following are the effects of inflation or a rise in prices :—

Creditors lose and debtors gain.

(1) Creditors as a whole lose, while debtors as a whole gain. This is because money borrowed at a time when it bought more, is paid back at a time when it buys less. Interest payments on the same also become of less value than before.

Producers and traders gain.

(2) Agriculturists, manufacturers, wholesalers and retailers obtain large prices simply by holding their stocks which rapidly increase in value. It also stimulates production and hence increases employment.

Persons with fixed incomes lose.

(3) Labourers and other persons with fixed incomes stand to lose. It has always been observed that wages and salaries do not rise at such times, if they rise at all, in the same proportion as the rise in prices. They lag considerably behind.

Social unrests.

(4) As a consequence of the above there arise social unrest and labour troubles. Strikes are very common during such periods.

(5) Consumers as a whole suffer, as they are required to spend more of their money to maintain the same standard of living as had been maintained by them previously.

Consumers suffer.

(6) Producers find it difficult to compete in the markets of the world, as the cost of production which they are required to incur as a result of the rise in the prices of the raw materials and other articles and services used by them during the process increase appalingly.

Producers can't compete in foreign markets.

(7) Because of the rise in money income, people think themselves better off and disregard for a time at least the rise in expenses. The misleading prosperity felt by them undermines the economic life of the country and usually leads to thoughtless extravagance. This is, in itself, deplorable.

Misleading prosperity.

Effects of deflation or a fall in prices

The following are the effects of deflation or a fall in prices :—

(1) Creditors as a whole gain while debtors as a whole lose. This is because money borrowed at a time when it bought less, is paid at a time when it buys more. Interest payments on it also rise.

Creditors gain and debtors lose.

(2) Agriculturists, manufacturers, wholesalers and retailers obtain less prices and hence production and business activities suffer seriously. This in its turn, brings about unemployment and results in disaster. It may also be, pointed out that of all classes mentioned above the first suffers the most. Reasons for it are not far to seek. We know that (1) agricultural commodities tend to decline in prices much more rapidly than other commodities, (2) as the time taken in the process of their production is consider-

Producers and traders lose.

ably longer, the expenses incurred at the commencement at one price-level are not made good by the income yielded at the end at another and lower price-level.

People with fixed incomes benefit.

(3) Those with fixed incomes benefit, as their money incomes purchase a larger share of goods and services. It may, however, be said that the rates of remuneration in certain cases are reduced as well, but here again the fall is usually less than that in the prices.

Unemployment.

(4) Consumers as a whole gain but difficulty is sometimes felt when increase in unemployment leaves a good many of them without any income.

Effect on exports.

(5) Exports do increase, if there is no corresponding fall in prices in foreign countries. But more usually what happens is that trade barriers are built to check the imports.

National progress is checked.

(6) The position of the country as a whole is jeopardised, as national progress is checked. Falling prices, in fact, deaden the desire to venture and thus lead to human retrogression.

APPENDICES

I

SHORT NOTES

Velocity of circulation. If we represent the total annual expenditure on commodities in any community by E and the average amount of money in circulation by M, it is hardly likely that the average amount of money in circulation, *i.e.*, M is equal to E, the total expenditure. The same monetary unit is used a number of times to do the requisite amount of work. The capacity of

money to change hands repeatedly is called its velocity of circulation. It may be calculated by dividing E by M. Hence $V = \frac{E}{M}$.

Depreciation. Money is said to have depreciated when its purchasing power falls. Supposing one rupee buys 20 units of commodities in general, if it begins to buy only 10 units it is said to have been depreciated. Rise of prices means depreciation of money. It is caused by inflation of money. *Appreciation* is just the opposite of depreciation.

Reflation. When supply of money (including credit) is made to increase to bring prices to a former level, it is known as reflation. This is correctly speaking controlled inflation. Uncontrolled inflation is dangerous. It may throw the whole economic structure of a country into disorder. In it was the evil odour about inflation which forced the people to call this remedy as reflation. This term was first used in U. S. A. in 1931 when the object was to increase the price-level to that of 1929. But the scheme met with a strong opposition and finally had to be abandoned owing to a defect in the legislation and a decree of the Supreme Court.

II

SUPPLEMENTARY QUESTIONS

Q. 1. State in simple form the Quantity Theory of Money making clear the hypothesis under which it is true. *(Delhi, B. A.)*

A. For an answer to this question please refer to first three paras of answer to Q. 20. For the discussion of hypothesis, the significance of the

phrase 'other things being equal' shall have to be discussed.

Q. 2. What is an index number ? Explain carefully the method of constructing a simple index number. What precautions should be taken in preparing the same ? (*Agra, B. A.*)

A. Please refer to Q. 29.

CHAPTER V

PAPER MONEY

[ITS KINDS, ADVANTAGES AND DISADVANTAGES.]

Q. 31. Mention the effects of an issue of inconvertible paper money. What is its chief evil, and how can this be avoided ? (U. P. 1936)

Inconvertible Paper Money. Inconvertible Paper Money consists of such notes as are not capable of being converted into coins or bullion or foreign exchanges by law. They circulate due to the force of law or confidence in the issuing authority or both. **Definition**

Its effects. The first effect of the issue of inconvertible paper money is to drive metallic money out of circulation. It is either hoarded or melted. In case, however, the amount of the paper money issued is less than the requirement, it also remains in circulation. But in the long run, as is evident from the currency history of the various countries, the amount of the notes increases, and the total currency becomes larger than the requirement. Next, if the intrinsic value of the metallic currency is less than its face value, it remains in circulation so long as the value of the paper money does not fall below its intrinsic value. If there is no force of law the metallic money under both these circumstances commands a higher value than the paper money. To use an economic term it acquires a premium. There is duplication of prices—one in metallic money and the other in inconvertible paper money. Market

Metallic money driven out of circulation.

Conditions under which it is not driven.

It acquires a premium.

Duplication of prices.

Rise in prices. quotations being, however, in terms of the latter, there is an all round rise in prices. This leads to a boom * in production and trade, high profits, speculation and loss to the labourers, consumers, creditors, and people with fixed incomes. As foreign payments are made in gold whose price rises, foreign exchange rates also rise.

Miscellaneous-effects.

Exchange rates rise.

Its chief evil. From the above discussion, it is clear that the chief evil of an inconvertible paper money is its over-issue. The business of note issue is either in the hands of the Government or the Central Bank. It has, however, been the experience of the people that there is always a danger of over-issue present more in case of the Government issue, as it is influenced by its own financial needs and is not subject to any control. Bank issue is, therefore, a safeguard, particularly due to the supervision of the Government. Besides, maximum amount of note issue must be strictly controlled with a view to keep the prices steady. Index numbers can help in this direction. As soon as they show a rise, extra currency must be withdrawn from circulation.

Over-issue.

Bank issue provides a safeguard.

Controlled issue is the best.

Q. 32. How does the issue of inconvertible paper money in a country affect the value of its currency in terms of (a) gold, (b) goods, and (c) foreign currencies ? (U. P. 1937)

A. **Inconvertible paper money in itself not bad.** Issue of inconvertible paper money in itself does not affect the value of the currency of a country. It is in all the cases determined in the same manner, *i. e.*, in relation to its supply and demand. The Quantity Theory of Money

* As every boom period is followed by a depression period, there is ultimate loss.

holds good everywhere. If the issue of inconvertible paper money in a country is according to the needs, the value of the currency remains steady. It is only when it is over-issued that the currency loses its value. This also happens under convertible paper money and metallic money. Any unnecessary inflation, under all systems of currency, surely brings about a fall in the value.

Only over-issue is bad

Over-issue affects it adversely. An over-issue of inconvertible paper money affects the value of the currency of a country. Let us consider it specially in terms of, (*a*) gold, (*b*) goods, and (*c*) foreign exchanges.

Gold. As inconvertible paper money has no relation with gold, value of the currency of a country with this type of money falls in its terms due to the loss of confidence as more and more of it is over-issued. The amount of the premium on gold represents the extent of its depreciation.

Fall in terms of gold.

Goods Similarly, the value of the currency of a country having inconvertible paper money falls in terms of goods. Prices in general rise. On account of a premium on gold, importers have to pay more for their imports. They, therefore, in order to recoup themselves of the loss, raise the prices of the goods. The raising of prices by importers leads to the raising of the prices by others too. Experience has shown that prices under a depreciating paper money regime, rise faster than is warranted by the increase in the quantity of paper money issued, perhaps because of the loss of confidence. The value of inconvertible paper money is dependent upon confidence, and once this confidence is shaken, fall in the value of the currency is abrupt.

Prices rise.

Exchange rates fall.

Foreign currencies. If foreign currencies are convertible into gold, the currency of a country wherein we have got inconvertible paper money falls in value in terms of them to the same extent as is the premium on gold. In cases where foreign currencies are also inconvertible, fall in value in their terms depends upon the relative depreciation of each currency in terms of gold and goods.

Q. 33. Describe the following two systems of paper money, giving their relative merits and defects :—

(a) Representative paper money ; and
(b) Proportional reserve system.

(U. P., 1938)

Full backing in bullion or coins

A. **Representative paper money.** Representative paper money is that which represents bullion or coins. There is a full backing of bullion or coins for all notes issued. It saves loss of metal due to wear and tear. The first introduction of notes was perhaps of this type. There is no danger of their over-issue inasmuch as there must be a corresponding metallic reserve. The certificates of gold or silver deposits in U. S. A. are such notes. The Hilton Young Commission had also recommended the issue of gold certificates by the Government of India, but the recommendation was not given effect to.

Fixed percentage of metallic reserve.

Proportional Reserve System. Proportional reserve system is that where a fixed percentage of the total issue of the notes is required to be maintained by the note-issuing authority in bullion or coins. In some countries, this includes foreign currencies also. Usually, the issuing authority keeps a larger proportion than is required. This system of note-issue became much prevalent

specially after the War of 1914-18. In the case of America, the legal minimum of gold and gold securities is 40%. In our own country, Reserve Bank of India is required to keep gold bullion and coins and sterling securities at least to the extent of 40% of the total note-issue. It is, however, generally much more.

Representative paper money.

Relative merits and defects. As there is a cent per cent metallic reserve for representative paper money, its value in terms of bullion is fixed for ever. There is no danger of any fall. But this does not mean that its value in terms of other goods also remains steady. Supposing a country has a huge reserve of gold which goes on increasing. In case currency is also allowed to increase at the same rate, without there being any increase in production of goods, its value in their terms is sure to fall. Next, if there is a shortage of gold, currency is not allowed to expand according to business requirements. In short, the system does not provide for elasticity. Besides, gold being scarce, all the countries of the world cannot adopt gold standard under this system. Over and above this, it is of no use to keep so much of gold in reserve. The population of the world is unnecessarily debarred from using, for the purposes of art, the most attractive material so generously provided by Nature.

Proportional Reserve System.

Proportional reserve system is advantageous from all these points of view. It provides for elasticity to a very great extent, economises the use of gold and thus allows the whole world to enjoy the blessings of gold standard, and makes the yellow metal available for the purposes of arts. Surplus gold is invested outside and a regular income is assured.

Q. 34. Examine the advantages and drawbacks of the following systems of note-issue :—

(a) Minimum Deposit System.

(b) Inconvertible Paper Currency. (Rajputana).

A. **(a) Minimum Deposit System.** Under Minimum Deposit System, the law usually lays down that the issuing banks should deposit a fixed percentage of the amounts of the issues with the premier bank in gold or government securities. This system prevails in United States, where member banks are required to invest a fixed percentage in securities and lodge them with the Federal Reserve Board.

Not convertible.

(b) Inconvertible Paper Currency. Inconvertible Paper Currency is that which is not convertible into bullion or coins (full-bodied). It circulates either because of the force of law or due to the confidence in the issuing authority or perhaps due to both.

Advantages and drawbacks of (a). Minimum Deposit System is advantageous from various points of view. It does not make the currency entirely dependent upon the availability of precious metals, as is under representative paper money system. On the other hand, there is no danger of its being issued without any limit. It means that the system provides both for elasticity and safety.

Elasticity.

Safety.

(b) Inconvertible Paper Currency. Inconvertible paper currency has got all the advantages of the convertible paper currency and a few more. Currency under this system is more elastic than under any other system. Besides, as no gold need be kept under this system of

More elastic.

Greater economy.

currency, the whole of it is available for investment or use otherwise. But this system of currency has a serious drawback inasmuch as it provides no restriction for over-issue. It is, therefore, the least stable form of currency and hence the most undesirable.

Defect due to over-issue.

Q. 35. Examine the advantages and disadvantages of the following systems of note-issue :—

(a) Partial Deposit Method.

(b) Proportional Reserve System. (U. P. 1941)

A. As partial deposit method is the same as the minimum deposit system, students are referred to the answer to Q. 33. The advantages and drawbacks of the same have also been discussed therein. The meaning of the partial reserve system along with its advantages and disadvantages has been discussed in the answer to Q. 32.

Q. 36. To what extent can paper money be safely issued ? Explain the possible dangers of issuing inconvertible paper money. (Calcutta 1934).

A. **Extent to which paper money can be safely issued.** Paper money can be safely issued to the extent of demand for it as represented by goods and services. In fact so long as this limit is adhered to there cannot be any difficulty for we know that the value of the monetary unit of a country is determined in relation to its supply and demand. This holds good with regard to all kinds of paper money—representative, convertible and inconvertible. It is only when supply exceeds the demand that the value falls. An unnecessary

It can be issued to the extent of demand for it.

inflation, under all circumstances, brings about a fall.

Ove-rissue results in deprecia-tion.

Possible dangers of issuing inconvertible paper money. As inconvertible paper money is liable to be over-issued, its value is affected in terms of everything, *e.g.*, goods gold and foreign exchanges.

Please see answer to Q. 32.

Q. 37 Discuss the various methods of regulating the issue of notes. (Allahabad, 1940)

A. There are at least seven methods of regulating the issue of notes.

Fixed fiduciary issue method.

Its nature.

Its deficiencies.

(1) The first method is what is known as the fixed fiduciary method. It was adopted, first of all, in England in 1844. Under this method, notes worth a fixed amount are required to be covered only by government securities, while all those issued in excess must be covered by metallic reserve. (*a*) It is deficient in elasticity because whenever there is an appreciable internal or external drain of the metal, an undue contraction of currency and credit is rendered necessary. (*b*) It is not sufficiently adaptable to heavy demands for currency as an expansion becomes impossible in case there is a shortage of the metal. But as against this, it may be said that it acts to a certain extent as a brake on undue expansion of currency and credit in times of prosperity. An element of elasticity was, however, introduced in the English system in 1928 when it was provided that the Treasury could authorise the fiduciary issue above £260 million to a special amount for not more than two years altogether from the date on which the authority was finally given.

Elasticity introduced in the English system.

(2) The second method is that of a fixed legal maximum of note issue. It was followed by France from 1870 to 1928. 'The system was altogether too rigid and incapable of sufficient adjustments to the requirements of the present money markets.' Moreover, it provided no guarantee against inflation as the Parliament could raise the limit at any time without any sufficient reason whatsoever.

Fixed legal maximum of note-issue.

Its defects.

(3) The third method is that where notes are required to be fully covered by Government Securities, and in addition limited to the paid-up capital and reserves of the issuing bank. It was formerly employed in the United States in the case of the National Bank notes. Its short-coming is that it does not provide for elasticity.

Fully covered by G. S. and limited to the paid-up capital, & reserves.

Inelastic.

(4) The fourth method is that where a small percentage of the total issue is to be kept in metallic reserve and the remainder is to be maintained in trade bills and government securities with the further provision that subject to certain conditions and penalties the metallic reserve percentage may be allowed to fall below a certain minimum. It was adopted in Germany in 1875 and with certain modifications in U. S A. in 1913 with the introduction of the Federal Reserve System and in various other countries after the War of 1914-18. A great advantage of this method is that while it provides sufficient elasticity there is also a considerable guarantee against an undue expansion of currency.

A small percentage in metallic reserve and the remainder in trade bills, etc.

Elastic and secure.

(5) The fifth method is that where just like the fourth method a small percentage of the total issue is required to be covered by metallic reserve but for the remainder there is no specification of

A small percentage in metallic reserve but no specification for the remainder.

the particular kinds of assets which may be used *as such. There is, however, a further provision under this method which makes the notes a first charge on all the assets of the issuing bank.* It gives the bank a greater freedom of action than is possible under the fourth method.

Propor-tional deposit method.

(6) The sixth method is the proportional deposit method. Under this system the issuing banks are required to deposit a fixed percentage of the amounts of the issues with the premier bank in gold or government securities. This system prevails in United States, where member banks are required to invest a fixed percentage in securities and lodge them with the Federal Reserve Board.

A variation of the fixed percentage method.

(7) The seventh method is a variation of the fixed percentage, wherein a fixed amount is to be kept in the form of securities of some foreign government or the balance of the bank of a foreign country. An example of this is found in the Indian system of note-issue.

Indian system.

APPENDICES

I

SHORT NOTES

Bank Money. Bank notes are known as Bank money. They contain a promise to pay a certain sum of money on demand to the bearer of the note. In almost all the countries, Central Bank has the monopoly of issuing such money and it is full legal tender.

Fiduciary issue. Under this system of note-issue all the notes above a certain maximum are required to be backed by cent per cent metallic reserve. The portion not backed in this way is

known as Fiduciary issue. Before 1928, the *Bank of England was allowed to issue notes upto a total of £19,750,000 without any metallic reserve. In that year, the amount of Fiduciary issue was raised to £260 millions. Since then it* has fluctuated several times. Before the acceptance of the recommendations of the Babington Smith Committee, we had in India also fiduciary issue system.

Currency v. Banking principle Fixed Fiduciary Issue System is known as currency principle of issuing notes, and Percentage System is known as the banking principle Under Fixed Fiduciary Issue System, the amount of the notes which can be issued on the security of the money invested is fixed for ever.

It can only be expanded by new Acts. The system is inelastic, as after the maximum limit has been reached all issues must be backed by metallic reserves. Percentage system or banking principle of note-issue, on the other hand, requires metallic reserve only to the extent of a fixed percentage. This system provides for elasticity ; for expansion of currency is in this case made possible only if a percentage is available in metal. Usually more than a fixed percentage is maintained in metal, and, hence, expansion becomes possible to a certain extent without metallic backing.

Fiduciary paper money. This kind of paper money is different from the representative paper money in so far as in this case, only a portion is backed by metal instead of the whole. All the note-holders are never likely to present them for conversion at the same time, and, hence, it has been found that in case only a portion of it is back-

ed by metal, their convertibility can be *assured at all times. The rest of the reserve is invested and becomes a permanent source of income. The amount of this invested portion also known as* the ***fiduciary portion*** may be fixed, or allowed to vary according to the volume of the total note-issue. In the former case, it is known as the Fiduciary System, and in the latter case as the Percentage System. When notes are presented they are converted, and because of this fact this kind of note-issue is also known as convertible note-issue.

II

SUPPLEMENTARY QUESTIONS

Q. 1.—Point out clearly the comparative merits of Fiduciary Issue System and the Proportional Reserve System of note-issue.

(*Delhi Inter. and B. A.*)

Please consult Fiduciary Issue and currency *v.* Banking Principle in Short Notes.

Q. 2. What do you think is the right principle of note-issue ? Illustrate your answer with reference to systems prevailing in different countries of the world. (*Rajputana*).

This question can be solved with the help of the answer to Q. 35.

CHAPTER VI

FOREIGN EXCHANGE

[MEANING OF ELEMENTARY TERMS, FACTORS INFLUENCING RATES OF EXCHANGE.]

Q. 38. Explain the term Mint Par and Specie points and show how and why the actual rates of exchange in the market fluctuate within the specie points (U. P. 1936)

A. **Mint Par.** Mint Par is the ratio of weights of standard gold or silver contained in the currency units of any two countries, having the same standard of value. It can be easily found out from the currency laws of those countries. The Governments or the Central Banks of the countries having metallic standards undertake to give and take a certain amount of currency of their respective countries in exchange for a fixed quantity of standard metal. The currencies of two countries are reduced to one common fineness in the light of these laws and their mint par is determined.

Relation of contents.

Let us now see it practically. Both U. S. A. and Great Britain had the same standard of value, namely gold, some years back.

An illustration.

British sovereign £1 contained 113·0016 grains of fine gold.

American Eagle ($ 10) contained 232·2 grains of fine gold.

Therefore $ 1 was equal to 23·22 grains of fine gold.

Therefore £ 1 was equal to $\frac{113 \cdot 0016}{23 \cdot 22} = \$4 \cdot 8665$

Hence, the London-Newyork or Sterling-Dollar Mint Par of Exchange was 4·8665.

Specie Points. The market rate of exchange, though depending on the mint par, is influenced by other equally important factors. It, in actual practice, shifts up and down the mint par, but again and again tends to return to it. This shifting is, however, not without limit. In fact, there are two points—one the upper and the other the lower—upto which these rates can usually shift. They are known as the specie points. These are determined by adding to or subtracting from Mint Par the cost of transport of metal from one country to the other.

Points upto which rate can vary.

Fluctuations due to the inequality of the supply of and demand for bills.

Accounts in connection with foreign trade are settled by means of bills of exchange. If exports of a country balance, supply of and demand for bills of exchange also balance. But this seldom happens. And, as price of bills, *i. e.*, the market rate of exchange also varies as its supply in relation to demand, there are fluctuations in it.

Fluctuations within Specie points. These fluctuations are, however, within the Specie points. Let us take a concrete case to illustrate it. Suppose, there is a greater supply of bills in London on New York than the demand for them. The seller will, under the circumstances, perhaps not mind giving a little more of American currency than the Mint Par. But this cannot exceed the Mint Par plus the cost of transportation of gold *i. e.*, the upper Specie point. As soon as it exceeds he will prefer to import gold.

Conditions of gold exports.

Similarly, let us suppose that the demand for bills is greater than their supply. Under the circumstances, buyers will be willing to accept a little less of the American currency than the Mint Par. But this can, on no account, be less than the Mint Par minus the cost of transportation. In case it is so, they will prefer to export gold. Thus from the above discussion it is clear that the actual rate of exchange in the market will fluctuate within the specie points according to the supply of bills in relation to the demand for them, but that it will not be allowed to cross the specie points.

Q. 39. Explain ~~briefly the factors which~~ determine the rate of exchange between two countries.

How is the rate of exchange of a country affected by (a) foreigners touring in it, (b) foreigners employed in it, and (c) foreign loans?

(*U. P. 1938*)

A. **Factors determining the rate of exchange.** Rate of exchange between two countries depends upon (1) the demand for and supply of Bills, (2) currency conditions, and (3) political conditions.

Three important factors.

(1) Demand for and Supply of Bills. Foreign accounts are settled by means of bills of exchange. Their supply and demand at one time is never the same. Hence there is always a competition going on as between their sellers and buyers in the foreign exchange market akin to that in any other market. If there is a greater supply of bills on foreigners than the demand for them, exchange rate rises, *i. e.*, more of foreign currency is available for each unit of inland currency, and *vice-versa.*

Excess supply the cause of rise in exchange rate and short supply that of the fall.

Demand for and supply of bills in their turn depend upon a number of factors :—

Invisible exports and imports.

(A) **Trade conditions.** These include not only the import and export of goods—merchandise and precious metals, but also of services, etc. We know that one nation earns from the other freights, commission, brokerage, premium, etc., for the services of shipping, banking, and insurance, etc. Then there are expenses of tourists, students and visitors, interest charges, and profits on money invested. The extent to which a country receives money for these constitutes its invisible exports and the extent to which it pays for these constitutes its invisible imports. Supply of bills depends upon the amount of exports and demand for them upon the amount of imports.

Purchase and sale of securities.

Loans.

Interest on loans.

(B) **Stock Exchange influences.** Buying and selling of international stocks whose prices are continually telegraphed from one financial centre to the other also affect the supply of and demand for bills as they bring about the transfer of money from one place to another. Besides, there are loans floated by one country into another. They involve transfer of money at the time of floatation and again when they are paid back. Interest charges on them, as we have already seen, also bring about an annual remittance of money. All these have their effect upon the supply of and demand for bills.

stment of Banks.

Arbitrage dealings.

(C) **Banking influences.** Banks invest money in the bill markets of other countries. They also issue circular notes and letters of credit. There are arbitrage dealings too. These are operations undertaken by certain bankers and merchants with a view to earn profits out of the

difference in the rates of bills at two or more financial centres. Thus, these are dealings in differences. All these affect supply of and demand for bills.

(2) **Currency conditions.** Currency conditions have a great influence on the rate of exchange. The extent of debasement in the metallic currency of the two countries determines the fluctuations in it. Devaluation and over-valuation have also their effects. In the case of inconvertible paper money, purchasing power of the respective currencies has to be measured, and relative depreciation between them has its influence.

Debasement

Devalution and over-valuation.

Purchasing power.

(3) **Political condition.** Political conditions by changing the trade relations through tariffs, quotas and restrictions or subsidies and bounties also influence the course of trade and, therefore, the rate of exchange. Political unrest, wars and the consequent uncertainties result in wide fluctuations of exchange rates.

Tariffs etc.

Wars etc.

Effects on the rate of exchange of a country by :—

(a) *Foreigners touring in it.* As the foreigners tour in a country, they utilise the services of the people residing there, and, hence, draw upon their country to pay for them. This has the same effect as the exports have. The suppply of bills is increased, and the rate of exchange tends to rise.

Rates of exchange rise.

(b) *Foreigners employed in it.* Foreigners employed in a country export their savings to their own countries. This creates a demand for bills and has the same effects as imports. The exchange tends to fall.

Fall.

(c) *Foreign loans.* As has already been seen, the effects of the foreign loans are of a varied nature. First of all, when loans are received money flows in. This raises the rate of exchange. Again, interest is paid upon it annually. This lowers the rate of exchange. Similarly, at the time of the repayment of loan, the rate tends to fall.

Affected both ways.

Q. 40. Explain Gold points.

The value of the dollar undergoes change in terms of the pound or franc every minute. Explain the causes of this. (U. P. 1940)

Their determination.

A. **Gold points.** Gold points are also known as specie points. They are found by adding to and subtracting from the mint par, the cost of transportation of gold. As mint par exists only between countries having the same metallic standard, gold points also exist only between countries having gold standard. The one found by adding the cost of transportation to mint par is the upper gold point and that found by subtracting is the lower gold point. They are called gold points because gold is exported or imported as soon as rate of exchange reaches either of them. When it is at the upper point, gold tends to be imported, and when it is at the lower, it tends to be exported. Suppose, England and America are on gold standard, and the mint par between them is \$4·8665 to the £. Assuming the cost of transportation of gold either way to be \$·024, upper gold point will be \$4·8665+·024= \$4·89 approximately and the lower gold point will be \$4·8665−·024=\$4·84 approximately from the point of view of England.

Between countries having G. S.

Upper and lower gold points.

Illustration.

Variation according to supply and demand of Bills.

Causes of the variation of dollar in terms of pound and franc. We know that the rate of exchange between two countries is seldom at

Every singl transaction affects the rate.

Effects of orders.

Effects of services.

Effects of transfers

par. It varies according to the supply of bills in relation to the demand for them. This in itself varies every minute according as the factors upon which it depends vary. The value of dollar in terms of the pound or franc is its rate of exchange with them. And, as every transaction between America and England or France affects the supply of bills in relation to their demand, it also affects the value of dollar in terms of the pound or franc. Let us see it by taking some examples. Suppose America places an order upon England or France. This one transaction will increase its indebtedness, and the value of dollar in terms of the pound or franc as the case may be will fall. The opposite will happen in case of an order being placed by any of these countries upon it. Every performance of service by Americans to the nationals of any of these countries or *vice-versa* changes the value of dollar in terms of currency of the country in question. Every transfer from one of these countries to America or from America to one of these countries brings about a change in the relation of dollar to their respective currencies. And these transfers take place every minute, not only because of the direct transfers between them but also because of the indirect transfers. London, France, and Newyork are international markets and other countries settle their indebtedness through them.

Change in purchasing powers.

Besides, the value of the dollar in terms of the pound or franc also depends upon their relative purchasing power. And as this changes every minute with the change in the supply of currency in relation to the demand for it, their values in terms of the others also change.

Market rate does not change every minute.

Market rate of exchange, however, does not change every minute as the effect of each transfer is not known. It is felt only when all of them combine or say, the effect of each transaction is so insignificant that it does not influence the market rate of exchange. But actual value of dollar in terms of the other currencies changes in fact every second, what to say of minute.

Q. 41. Discuss the factors which are responsible for changes in the value of the rupee in terms of foreign currencies. (*U. P. 1941*).

Sterling Exchange standard prevalent in India.

Its effect.

Variation in the value of rupee in terms of sterling limited.

This variation due to ordinary causes.

A. Before discussing the factors responsible for changes in the value of the rupee in terms of foreign currencies, it must be said that India has got sterling exchange standard. Under this standard, the rupee has no direct value in terms of foreign currencies other than the sterling, the currency of the United Kingdom. It follows, then, that the factors responsible for changes in the value of the sterling in terms of foreign currencies will also be the factors responsible for changes in the value of the rupee in their terms. Next, one of the characteristics of the sterling exchange standard, as it prevails in India, is that the value of the rupee in terms of the sterling can change only to a limited extent. The Reserve Bank of India is always prepared to purchase and sell sterling for rupee at 1s. $6\frac{1}{8}$d. and 1s. $5\frac{29}{32}$d. respectively upto a certain minimum. The changes within the limits mentioned do take place, and the factors responsible for the same are the factors responsible for the changes in the value of any currency in terms of the other currency.

Rate of exchanges between

These are the days of inconvertible paper money. Rate of exchange between countries

having paper money as their monetary standard is determined by their respective balances of payments—and the demand for and supply of foreign bills based on such a balance. The balance of payment of or to India depends like the balance of payment of or to any other country upon a number of factors. *First of all*, we have got the balance of trade. Generally India has a favourable balance of trade. Sometimes however, this balance turns unfavourable. The tendency for the exchange rate under a favourable balance of trade is to rise, and *vice-versa*. So whenever, India's balance of trade is favourable the tendency for the exchange value of the rupee is to rise and *vice-versa*. *Next*, we have got payments and receipts on various other accounts, *e.g.*, loans, interest on them, remuneration for services, transference of money for benevolent purposes expenditure of various Governments (Central and Provincial), and expenses of students and tourists. If the net effect of all these is a payment, the exchange rate tends to fall, and if it is otherwise, it tends to rise. *Besides*, stock-exchange operations and Arbitrage dealings have also got their effect upon the exchange rate. If Indians purchase foreign stocks and shares, payment is required to be made, and if they sell, money is required to be received. On the other hand, if the foreigners purchase Indian stocks and shares or sell them, the effect is just the opposite. The net result of all these operations naturally, influences the balance of indebtedness or receipt and through it the exchange rate. Coming to the arbitrage dealings, these are the operations in exchange by purchasing or selling the currency of one country through the currency of another country, or currencies of several countries. For

countries having paper standard is dependent upon their respective balances of payments

These depend upon various factors.

Balance of trade.

Payments and receipts on various other accounts.

Stock exchange operations and arbitrage dealings.

example, there may be a difference between the quotation of Yen, the Japanese currency, in India from the equivalent of the same in rupee after taking into consideration the rupee-sterling rate and the yen quotation in sterling. Such operations also by influencing the net balance of payment or receipt influence the exchange rate.

Purchasing Power Parity Theory.

Gustav Cassel, a well-known, economist of Sweden, however, pointed out during the War of 1914-18 that the value of a foreign currency is judged by its command over goods and services, and the exchange rate between any two currencies is determined according to their relative purchasing power. But there are certain short-comings of this theory. *Firstly*, index numbers measuring the purchasing power of money may not be sufficiently reliable. *Secondly*, goods may not find their true level of prices due to violent movements of exchange rate. *Finally*, this theory ignores all the factors which are taken into consideration in determining the rate of exchange according to the balance of indebtedness theory already discussed. So, we may conclude that the changes in the value of the rupee in terms of foreign currencies are brought about by all the factors which go to make up the balance of indebtedness in this country and the United Kingdom.

Shortcomings.

Index numbers not reliable.

True level of prices may not be reached.

Other factors ignored.

Q. 42. Explain 'Gold-points.'

Discuss the following statement, and give reasons :—

'The value of rupee changes every minute in terms of pound or dollar.' (U. P. 1942)

A. This question can be solved with the help of the answer to Q. 40.

Q. 43 (a). Explain the factors which are responsible for determining the rate of exchange between two countries—

(i) When both are on gold standard.

(ii) When both are on paper standard.

(iii) What is meant by Purchasing Power Parity? (*U. P. 1948*)

A. **Factors responsible for determining the rate of exchange between two countries (i) When both are on gold standard:** Factors responsible for determining the rate of exchange between two countries when both are on gold standard are (1) the relative values of the two currencies in terms of gold, (2) the demand for and supply of bills, and (3) other conditions. Three factors.

(1) **The relative values of the two currencies in terms of gold.** The relative values of the two currencies in terms of gold depend upon the relative weights of gold defined in the laws of the countries as the basis of their respective standards. When U. K. and India were both on gold bullion standard, the weights of gold defined in the laws of the former (U. K.) and the latter as the basis of their respective currencies *i.e.*, pound sterling and rupee were 113 and 8·475 grains in order of their mention. Taking this factor alone, the rate of exchange between pound sterling and rupee was $\frac{8{\cdot}475\times240}{113}$d =18d. for a rupee (£1=240d.). But this was only a normal rate, and known as mint par of exchange in banking parlance. Actual rate of exchange varied because of other factors *i.e.*, the demand for and supply of bills and other conditions. The variations were, however, limited. In

Their determination.

Illustration.

Normal rate.

Actual rate varied because of other factors.

Variation is limited.

India, they were limited to 1s. $5\frac{29}{32}$d. and 1s. $6\frac{1}{8}$d., the rates at which the Government of India was *prepared to sell and purchase sterling. In other countries, they are limited by what are known as upper and lower specie points (mint par of exchange plus cost of sending gold and mint par of exchange minus cost of sending gold).*

Influence of bills.

(2) The demand for and supply of bills of exchange. Foreign accounts are settled by means of bills of exchange. Their supply and demand at one time is never the same. Hence, there is always a competition going on as between their sellers and buyers in the foreign exchange market akin to that in any other market. If there is a greater supply of bills on foreigners than their demand, exchange rate rises, ***i.e.***, more of foreign currency is available for each unit of inland currency and ***vice-versa***. This rise and fall can, however, not be above and below the upper and lower specie points respectively as in that case gold would be exported and imported.

Bills dependent upon various factors.

Supply of and demand for bills, in their turn, depend upon a number of factors, *e.g.*, trade conditions, stock exchange and banking influences.

(3) Other conditions. These are banking development, bank rate, national budget, political and industrial outlook and tariff rates, exchange restrictions and quotas, etc.

There is no limit to variations.

(*ii*) **When both countries are on paper standard.** In this case as well, the factors responsible for determining the rate of exchange between two countries are the same as in (*i*), the only difference being that the relative values of the two currencies are not taken in terms of gold but in terms of commodities and services in

general. Besides, there is no limit to the rise and fall of the actual rate of exchange at any particular time *as gold is not allowed to be freely exported and imported, there being no gold standard.*

(*b*) **Meaning of Purchasing Power Parity.** It has been said above that in case of currencies based on paper standard, the relative values of the two currencies are taken in terms of commodities and services in general. Gustav Cassel, a well-known economist of Sweden was the first to draw our attention to this fact during the war of 1914-18. He said that the rate of exchange between any two currencies is determined according to their relative purchasing power parity. But there are certain shortcomings of this theory. Please look to these in the answer to Q. 41.

Meaning.

Shortcomings.

Q. 44. Explain fully how the value of money of a country is determined in terms of that of other countries. (Calcutta—1937).

A. This question can be solved with the help of the answer to Q. 39.

Q. 45. What do you understand by monetary instability? What are its effects?

(Calcutta 1937)

A. **Meaning of monetary instability.** Monetary instability means a rise or fall in the value of a monetary unit either in terms of commodities and services or in those of foreign exchanges or both.

Variation in terms of commodies and exchanges.

Effects of monetary instability. Monetary instability is always deplorable. As 'short weight cheats the buyer; long weight cheats the seller', in like manner a unit of money changing in its power to buy upsets contracts. We will in the

It is deplorable.

following pages discuss the effects of monetary instability in terms of (1) commodities and services and (2) foreign exchanges separately.

For effects of monetary instability in terms of commodities and services, students are referred to the answer to Q. 30.

Effects of changes in exchange rates. If the value of the home currency in terms of foreign exchanges rises, the following are the effects : –

Importers gain.

(1) Importers gain, as they are enabled to charge the same price in home currency as before for goods which cost them less, But should they decide to charge a lower price on that account, they increase their sales, and hence ultimately increase their profits.

Exporters lose.

(2) Exporters lose, as they are forced to charge a lower price in home currency for their exports in order to enable them to be sold at the same price in the importing countries as before. If, on the other hand, they charge the same price in home currency as before they increase the cost of their goods in foreign countries. This results in a reduction of sales and hence, of profits as well.

An exception.

If, however, articles of exports are of necessity or of a monopolistic nature, they may not lose.

Producers lose.

(3) The producers, as a class, lose. In case there is a competition between home-made and foreign goods, producers have to reduce their prices. Besides, if their products form the items of exports, they have to charge lower, or if they do not do this they are hit by a reduction in their demand. Finally, even if there is no competition in home market in goods produced by them and those imported or if they do not form the items of exports,

they have to lower their prices in sympathy with the lowering of the prices of other countries.

In cases of, however, the producers of articles of necessity, there may not be any difficulty. An exception.

(4) As a result of depression in home industries, wages are reduced and figures of unemployment go up, and hence labourers as a whole lose. Labourers lose.

(5) Creditors as a whole gain while debtors as a whole lose in this case also as in the case of a fall in prices. Creditors gain and debtors lose

(6) People with fixed incomes benefit just as they do when there is a fall in prices. People with fixed incomes gain.

(7) In case, the government of the country has to meet certain fixed expenses in foreign countries, it gains by a reduction in the amount of home currency required to send the fixed amount. Govt. gains.

(8) Foreigners residing in the country are enabled to transmit more money in their home currencies by sending the same amount in the currency of the country in which they reside as before. Foreigners residing in the country gain.

(9) Consumers as a whole gain in the same way as they do when prices fall. Consumers gain.

The opposite happens in the case of a fall in the exchange value of a currency.

Q. 46. What do you understand by specie points? Are specie points applicable at the present time, to countries like England, India and France? (1935).

A. [For an answer to the first part of the question please refer to the answer to question No. 40.]

Specie points are not applicable to any of these countries at the present time. In fact,

Not applicable to any of the countries mentioned herein.

they apply to countries having gold standard, and we know that none of the countries mentioned herein has gold standard these days. India has, what is known as, sterling-exchange standard, and the Reserve Bank of the country is prepared to purchase and sell sterling at fixed rates and without any maximum limit. Again, England and France have got a system of exchange control.

APPENDICES

SHORT NOTES

Cross rates. Rates of exchange quoted in one monetary centre on other centres is cross rate of that particular centre from the point of view of any other centre. For example rate of exchange quoted in London on Berlin, Newyork, or France is cross rate of London from the point of view of India.

T. T. (telegraphic transfers). These may be Bank's selling or purchasing rates on different monetary centres. Banks buy exchanges at lower rates and sell them at higher rates. Bank's selling T. T. ready on London, for example, means the rate at which the banks are prepared to pay in London sterling for currency of the country wherein the quotation is given as soon as the cable reaches there; cable charges are borne by the purchasers of T. T. Similarly, we may have Bank's buying T. T. ready on London. Place will always be mentioned.

D. D. Rate. This is different from the T. T. rate inasmuch as in this case purchasers have to wait for sometimes before payment can be made in a foreign country. The time for which

they have to wait is usually the time taken for the mail to reach the place.

Unfavourable Rate of Exchange. This term is a relic of the Merchantilists. They regarded that rate of exchange unfavourable at which gold begins to be exported. In fact, no rate can be unfavourable for all the parties, in a country, as there are diverse interests and parties everywhere, and their interests are very often antagonistic. The interest of debtors and creditors are not the same. The interests of exporters are not identical with those of importers. Besides, there are both high and low rates, and we cannot say as to which of them is unfavourable, because they are sometimes quoted in foreign currencies and at others in home currency.

Exchange Control. There is, all the world over, at present a system of inconvertible paper currencies in prevalence. But exchanges between them are not allowed to be governed according to any scientific theory. They have, rather, been arbitrarily fixed by their governments. It is, in fact, to this governmental interference in foreign exchanges that we refer, when we use the term exchange control or exchange regulation. It may be defined as all interferences by monetary authorities on the exchange markets. There are several methods of exchange control, and their number has been increasing in recent years. The examples are :—

(1) *Regulation of foreign trade* which means adoption of such devices as tariffs, quotas, licences and giving of bounties, subsidies or drawbacks.

(2) *Rationing the supply of exchanges* which

means monopolising the right of buying and selling foreign exchanges at fixed rates.

(*3*) ***Establishment of Exchange Equalisation or Stabilisation Fund*** which is used to check fluctuations. The portion held in foreign exchanges and gold is used for preventing a fall in the rates and that held in home currency is used for preventing a rise in them.

(*4*) *Bank Rate.* This is lowered or raised according as rate of exchange is desired to be changed.

(*5*) *Blocked Accounts.* Sometimes restrictions are placed on the withdrawals of the deposits of the foreigners with a view to raise the rate of exchange.

(*6*) *Standstill Agreements.* Sometimes foreign creditors are induced to agree not to withdraw their loans.

(*7*) *Clearing Agreements.* These are the agreements to clear foreign balances in one form or the other.

II

SUPPLEMENTARY QUESTIONS

Q. 1. On what do the gold points depend? Can exchange go beyond the gold points? If so, when and how?

(*Punjab, B. A.*)

For answer to the first part of the question please take help from Specie Points in Q. 38 and Gold Points in Q. 40.

Exchange rates can go beyond Gold Points :—

Gold using countries.

(1) There can be gold points only between two countries having gold standard.

(2) Gold points may themselves vary.

(*a*) Charges of transmission themselves vary. **Variation of charges.**

(*b*) During war period, gold is not allowed to be exported. Balances are carried down to other years, and the governments exercise control over exchange rates. **Exchange control.**

(*c*) If the Central Bank charges a small premium on all gold purchased from it for purposes of export. **Gold at a premium.**

Q. 2. What do you understand by favourable and unfavourable balances of trade ? What other factors influence the rates of exchange ?

For an answer to the first part of the question, please refer to this heading under Short Notes, and for an answer to the second part, please refer to the answer to Q. 39.

CHAPTER VII

INDIAN CURRENCY AND EXCHANGE

[HISTORY]

Q. 46. A. Write a short note on the history of Indian currency between 1835 and 1893.
(Allahabad, 1940.)

A. **A short note on the history of Indian currency between 1835 and 1893.** From 1835 to 1893, India had a silver standard. Mints were open to free coinage of silver. Face value of the rupee was equal to its intrinsic value. This period of the history of Indian currency is very instructive. *First of all*, a change in the value of precious metals brought with it great difficulties in maintaining the stability of the rupee. *Secondly*, with a view to do away with these difficulties, a number of experiments were suggested and tried.

Silver standard.

Face value

Instability.

Experiments suggested and tried.

Attempts to introduce gold in circulation 1835-74. Gold had been completely demonetised by the Coinage Act of 1835, though mints had been left opened to the public for its free coinage. Gold mohurs and Rs. 30, 10, and 5 pieces though coined had ceased to be legal tender currency. In pursuance to the people's demand, a proclamation issued in 1841 authorised receipt of gold coins at public treasuries in payment of public dues at their face value. This meant that the rate of exchange between gold and silver was fixed at 1 : 15, as the gold mohur and the silver rupee

Gold demonetised in 1835.

Proclamation of 1841.

were of identical weight and fineness (face value of the gold mohur was Rs. 15). During 1848-51 gold mines were discovered in California and Australia. The result was a fall in the value of gold relatively to the silver. This led the people to pay the treasuries in gold coins which were accepted there at the fixed rate. Gold began to flow to the treasuries in large quantities and the Government lost by accepting it at a rate higher than the market rate. Hence, a Notification was issued on 25th December, 1852, by which the privilege given in 1841 was withdrawn and it was declared that on or after, 1st January, 1853, no gold coin will be received on account of payments due, or in any way to be made, to the Government in any public treasury within the territories of the East India Company. This had the effect of driving out of circulation, and turning into hoard £. 120 million worth of gold coins, as H. D. Macleod estimates in his book on Indian currency. There was again an agitation in favour of gold, and ultimately the Government had to agree to receive and pay when convenient sovereigns and half-sovereigns minted at any authorised mint in England or Australia at the rate of Rs. 10 and Rs. 5 respectively. But they were not to be legal tender. The agitation in favour of a gold currency in active circulation, however, went on and the Government had to appoint Mansfield commission in the end in 1866. This commission recommended the introduction of gold coins and making them legal tender after some time when they became popular. But nothing could be done. In 1868, the rate for the receipt of sovereigns and half-sovereigns was raised to Rs. 10-8 and Rs. 5-4 respectively. In 1872,

After 1848 gold coins flooded in Treasures.

1841 Proclamation cancelled.

Gold coins hoarded.

Gold coins again accepted.

Mansfield Commission.

Rate increased.

Sir Richard Temple episode.

Sir Richard Temple, the then Finance Member of the Government of India recommended a gold standard, but after some time he resigned, and the Government finally decided against gold standard in 1874.

International Monetary Conferences.

Fall in the gold price of silver. By 1874, price of silver had begun to fall, and attempts made to arrest it from 1867—92 did not bear fruit. Four international monetary conferences were called with this end in view in 1867, 1878, 1881 and 1892. In 1878, the Government of U. S. A. passed an Act known as the Bland Allison Act which authorised the Secretary of the Treasury to purchase and coin each month not less than 3 million dollars and not more than 4 million worth of silver into standard silver dollars. The purchases were made, but without any result. Next, in 1890, Sherman Act was passed which required the purchase of not less than 54 million ounces of silver annually. It was 35 to 43 per cent of the world's production and thrice of what was bought under the Bland Allison Act. There was, no doubt, a temporary rise in the price of silver, but this could not help much. In 1893, the silver purchase clause of the Act was repealed as a consequence of the failure of the last international conference. A Royal Commission, *viz.*, the Gold and Silver Commission was appointed in England in 1886 to enquire into the changes that were taking place at that time in the relative values of the precious metals but without any practical results. All through the years 1874—93, the Government of India had been feeling acute distress because of the fall in the price of silver, and hence it also could not sit silently. First of all, Col. J. T. Smith, Master of the Mint at Madras and

Bland Allison Act.

Sherman Act.

Gold and silver commission.

Attempts of the Govt. of India.

next the Government of India laid down schemes for the adoption of gold standard in India but they were dropped by the Secretary of State for India. Then, the Government expres ed itself in favour of bimetallism. But this also did not receive the support of the Secretary of State. Finally, a despatch was sent containing proposals for the closure of Indian mints to the free coinage of silver and the adoption of gold standard on a new basis. Upon this, the Secretary of State for India appointed a currency commission, *viz.*, Herschell Commission.

Herschell commission

Q. 47. Detail the circumstances leading to the closing of the Indian Mints to free coinage of silver, and mention the effects of this step.
(U. P. 1936)

A. **Circumstances leading to the closing of the Indian Mints to the free coinage of silver.** During the period of 20 years preceding the closing of the Indian Mints to the free coinage of rupees, price of silver had been falling due to the (1) abandonment of silver standard and adoption of gold standard by the important countries of Europe, (2) increased supply of silver from the new mines discovered during that period, (3) reduction in its cost of production because of the simplification of the mining processes as a result of new inventions, and (4) decrease in the supply of gold because of the exhaustion of the Australian mines. This had its effects upon India in several ways. (1) There was a fall in the rate of exchange from about 2*s.* in 1872 to about 1*s.* 3*d.* in 1893. (2) The effect on the general level of prices in India was very much depressing. Cheap silver was imported in large quantities to liquidate her

Falling price of silver.

Causes.

(i) Effects Fall in exchange rate and (ii) rise in general price level.

favourable balance of trade. The mint being open to its free coinage, total currency in circulation exceeded the requirement and this resulted in a rise in the general level of prices. (3) Depreciation of the rupee brought the Government of India also in difficulties. It had to remit £17 million to England every year by way of Home Charges. While it meant about Rs. 14 crores in 1873, it meant about Rs. 26 crores in 1893. Means available for making up the deficit were either increase of taxation or curtailment of expenditure. But none of these was possible. (4) India's foreign trade was seriously harassed by fluctuations in exchange rate. It is said that the tendency of a falling exchange is to stimulate exports. Statistics, however, prove that it was quite contrary. For example, from 1871-72 to 1876-77, gold value of the rupee fell by 11¼ per cent but exports were actually less in the latter year than in the former. (5) Want of a stable exchange, and the fact that it had fallen so heavily, greatly checked the investment of foreign capital in India and the consequent development of the country. (6) By making silver the standard and keeping the Indian mints open to its free coinage the country was made to buy depreciating metal. (7) Europeans employed in India could send lesser amount in sterling to their dependents in Europe for the same amount of rupees as before.

(iii) Difficulties of Government.

(iv) Foreign trade harassed.

(v) Inflow of capital checked.

(vi) Depreciating metal pouring in.

(vii) Difficulties of European employees.

The effects of closing the mints. The effects of closing the mints were as follows: *Firstly*, there arose a divergence between the value of the rupee and the price of silver. This led to spurious coinage which became an extremely profitable enterprize. *Secondly*, uncoined

(i) Divergence between value of rupee & silver & spurious coinage.

silver and silver ornaments in hoards were depreciated in value. *Thirdly*, the Government of India got the exclusive power of expanding or contracting the currency at will. This made it unautomatic. *Fourthly*, the trade of the country with China, a silver using country, which took a large quantity of India's manufactured goods was made difficult. These were the effects which were harmful to the country. But then all of the difficulties referred to previously were removed. The value of rupee rose in and outside the country. Rupee-Sterling rate—nay exchange rate—with all the gold using countries became stable.

(ii) Depreciation of metallic value.

(iii) Currency made artificial.

(iv) Trade with China.

Advantages.

Q. 48. Examine the effects of the fall in the value of silver in 1870—75 on India's trade, industry and the State.

(U. P. 1941)

A. **Effects of the fall in the value of silver in 1870—75 on India's trade, industry and the State.** The following were the effects of the fall in the value of silver in 1870—75 on India's trade, industries and the State :—

Trade. As the price of silver fell, it was imported in this country in more and more quantities with a view to liquidate her favourable balance of trade. It may be recalled that the mints were open to the public at this time for the free coinage of the rupee. So, when this silver entered into circulation as money, total currency in circulation exceeded what was actually needed and it resulted in a rise in the general level of prices. This, in its own turn, had its effects on the internal trade of the country. Rising prices, as a rule, result in the fall of consumption, which

Silver imported.

Increased circulation of money and rise in prices

Internal trade adversely affected.

External trade harassed.

fact alone is suggestive of an adverse effect on the internal trade. As far as the external trade was concerned, it was also seriously harassed by fluctuations in the rate of exchange. With every increase in the quantity of rupee coins in circulation there was a corresponding fall in its exchange rate with currencies based on gold. It was not, however, so much the fall of exchange which was complained of, as the fluctuations, whether in one direction or the other. Any sudden or violent fluctuation almost paralyses external trade for a time, be it the import trade or export. It may, however, be said as against this that the tendency of a falling exchange is to stimulate exports. But the examination of the statistics does not support it. On the contrary, it shows that this had been less during the period than previous to it.

Exports not supported.

No mill industries worth the name.

Industries. As regards the effects on industries, it is generally said that rising prices act as a stimulus to production. We must, however, remember in this connection that there were no industries worth the name at that time in this country excepting that of agriculture. Mill industries were in their infancy, and depended mainly on foreign investments in the country. Want of a stable exchange had put a check on it. Uncertainty as to the interest which would be received for the investment and as to the diminution which the invested capital might suffer if it were desired to retransfer it* was responsible for this. Agricultural industry, however, did make some progress, but agriculturists, as a whole, did not gain because of a number of factors working against them.

They depended upon foreign capital whose flow was checked.

Agricultural industry made progress but agriculturists did not gain.

* Herschell Commission Report.

The State. The effects on the State were also far from satisfactory. The main reason of this could be found in the fact that the Government of India had to make remittances annually from India to U. K. to the extent of nearly £17 million sterling and the fall in the exchange rate of the rupee meant that more and more of the Indian money was required to be sent. The result was that the surplus budget turned into deficit in spite of the improvement in revenue. Further taxation could not be resorted to and any reduction of expenditure was next to impossible. There was a strong agitation in favour of the increase in the salaries of the Government employees because of an unprecedented rise in the prices of the articles of necessity. Englishmen demanded more money over and above this for the remittance of sterling to their dependents at home.

Increased amount of rupee currency required to meet Home charges.

Deficit budget.

Demand for increase of salaries.

Q. 49. Summarize the recommendations of the Herschell Committee of 1892. What steps were taken by the Government of India thereon, and with what result? *(U. P. 1942)*

A. **A summary of the recommendations of the Herschell Committee of 1892.** The following were the recommendations of the Herschell Committee of 1892 :—

(1) That the mints be closed to free coinage of both silver and gold. Till then, they were open to free coinage of the latter as well, though gold coins were not legal tender.

Closure of mints.

(2) That the Government could coin rupees in exchange for gold at a rate of 7'53344 grains troy of fine gold or 1*s*. 4*d*. per rupee.

Gold coinage allowed to Govt.

(3) That gold coins be received at public treasuries at the rate of 1*s*. 4*d*. per rupee.

Gold coins received.

Rupee coins

(4) That rupee coins should continue to be unlimited legal tender.

A transition period necessary before the introduction of gold standard.

Evidently, it did not make any specific provision for the introduction of a gold standard. But this was contemplated to be established in future. It was thought that a transition period was necessary in which the rate of exchange would be brought upto 1*s.* 4*d.* When this was achieved a gold standard would be established. At least this is what was emphasized by Lord. Farrer and Lord Welly. They also thought that a gold reserve would be provided for in the mean time.

Act and Notifications.

The steps taken by the Government of India on the recommendations. The recommendations of the Herschell Committee were accepted and Act VIII of 1893 was passed on June 26 of the same year. Three notifications were also issued in this respect.

Closure of mints.

The Act provided for closing the mints to free coinage of both gold and silver. It, however, allowed the Government to retain the right to coin silver on its own behalf.

The notifications issued were :—

Receipt of gold.

(1) Gold coins and gold bullion would be received at the mints in exchange for rupees at the rate of 7·53344 grains troy of fine gold, *i.e.*, 1*s.* 4*d.* per rupee.

Receipt of sovereigns.

(2) Sovereigns and half-sovereigns would be received in payment of sums due to Government at Rs. 15 and Rs. 7-8 respectively.

Issue of notes against gold.

(3) Currency notes would be issued in exchange for gold coin or bullion at the same rate. Currency notes could be i

gold in accordance with the Paper Currency Act of 1882 as well. But the amount of notes thus issued could not be more than 25% of the total metallic reserve.

Results of the above steps taken by the Government. For results of the above steps taken by the Government, please look to the effects of the closing of the mints in answer to Q. 47.

Q. 50. Summarize the recommendations of the Fowler Committee. To what extent were they adopted by the Government of India ?

(U. P. 1940)

A. **Below is a summary of the recommendations of the Fowler Committee :—**

(1) That the British sovereign be made a legal tender and current coin in India and that Indian mints be thrown open to the unrestricted coinage of gold. **Gold currency.**

(2) That the rupee coins be continued to be given by the Government in exchange for gold but be not coined until the proportion of gold in the currency was found to exceed the requirements of the public. **Coinage of rupees not to be resumed.**

(3) That profit on the coinage of rupee be in future kept in gold as a special reserve. **A new reserve.**

(4) That when the Government has accumulated a sufficient gold reserve and so long as gold is available, its obligations be discharged in India in gold instead of rupees. **Government to give gold.**

(5) That the relation of the sovereign to the rupee be 1s. 4*d*. per rupee. **1s. 4d. ratio**

(6) That the rupee, although made a token coin, be kept unlimited legal tender. **Position of rupee.**

In short it recommended gold currency for *India with the only proviso that rupee though a token coin was kept unlimited legal tender* and *made convertible into gold or sovereign only so long as it was available with the Government.*

Conclusion.

Extent to which they were adopted. The recommendations of the Committee were accepted in their entirety and sovereigns and half sovereigns were made legal tender throughout India at Rs. 15 to the pound. But as soon as the steps were taken to give effect to other recommendations, there were created difficulties. *First of all*, a gold mint could not be opened as the sanction of the Royal Mint was not received mainly because the authorities did not think that sufficient gold would be made available to enable the mint to continue for a long time, nor did they think it advisable to let the Indian Treasury bear the cost of the mint. Besides, they questioned the very necessity of a gold mint for India, as if all the members of the Committee had recommended it foolishly.

British Standard coins made legal tender.

The idea of gold mint was dropped.

Secondly, quite contrary to the recommendation of the Committee, coinage of rupees had to be resumed very soon by the Government. There was first of all the general monetary stringency, as no rupees had been coined after 1893. With the growth in business, the stringency was bound to be felt. Then, there were the consequences of the Act of 1898. The additional issue of notes against gold tendered in London necessitated the fresh coinage of rupees to ensure their convertibility. At first, the Government of India made an effort to induce the people to use sovereign but failing in the same they had to coin fresh rupees.

Rupee coinage resumed

Thirdly the use of the special reserve whose creation was recommended by the Committee *out of the profit on rupee coinage was changed. In the first instance,* the Secretary of State decided to get it transferred to London where he invested it in sterling securities. *Next,* a portion of the same began to be kept in India in the form of rupees. Besides, more than £1 million was diverted out of it to the capital expenditure on railways. The consequence of all this was that when during the crisis there arose a demand for remittance of gold to London in liquidation of India's unfavourable balance of trade, the Government could not meet it. But as the rupee-sterling rate showed a tendency to weaken, reverse councils were offered in this country and were met out of the proceeds of the sale of sterling securities held in the reserve in London.

Use of the Reserve changed.

Invested in sterling securities.

Rupee Branch established.

Diversion.

Demand for gold not met.

Reverse councils introduced.

Finally, flow of gold into India was checked by the Secretary of State by selling Council Bills without limit and at times at something below gold point against the currency reserve.

Inflow of gold checked.

Q. 51. Summarize the recommendations of the Fowler Committee. What steps were taken by the Government of India thereon, and with what results? (*U. P., 1943.*)

A. **A summary of the Recommendations of the Fowler Committee.** Q. 50.

Steps taken by the Government of India on the recommendations of the Fowler Committee and the results thereof. The Government of India passed the Indian Act No. XXII of 1899, making sovereigns and hals-sovereigns

British currency made legal tender.

legal tender throughout India at Rs. 15 to a £ (1s. 4d. to a rupee). Active steps were taken to open a mint for the coinage of gold in India. An active effort was also made to induce the people to use gold coins as a medium of exchange; and currency offices, post offices and other Government institutions were instructed to pay these to the public. But this proved unsuccessful. A large number of gold coins returned to Government Treasuries. In many places, sovereigns went to a discount of 4 as. But there was a demand for rupees, and the Government, contrary to the recommendations of the committee, was compelled to resume their coinage early in 1900. The profits on it were, however, credited to a separate gold reserve which finally came to be known as a gold standard reserve, and whose location, form and uses were subsequently changed from the recommendations of the committee. After 1900, the experiment of putting gold coins into circulation was not repeated. The net result of all this was the establishment of a gold exchange standard in India and not that of a gold currency standard as contemplated by the Committee

Steps to open a mint.

Attempts to introduce gold coins and their failure

Rupee coinage resumed.

Gold standard reserve.

Gold Exchange standard.

Q. 52. Why and how was gold exchange standard established in India ?

(Rajputana)

A. **Establishment of gold exchange standard in India.** Gold exchange standard was established in India in the first decade of the present century. The Secretary of State for India had to incur certain expenses in England on behalf of the Government of India, and to collect these, he used to issue bills in London drawn on the Government of India known as Council Bills. At first, these were issued only to the extent of

When Estd.

Rate not allowed to rise by the device of council bills.

his requirements but later on the practice was changed and they began to be issued without limit at 1*s*. $4\frac{1}{8}$*d.* which was the normal gold export point as well. The result of this action was that the exchange rate could not rise above this level. These bills soon became very popular in England as they provided for the importers of Indian goods a suitable medium of payment. The issue of these bills to an unlimited extent was made possible because of the establishment of the branches of the gold standard and paper currency reserves in London. The funds received by the Secretary of State for India by the sale of the council bills were credited either to the gold standard reserve or to the paper currency reserve, and notes and coins were issued in this country on their basis in their payment. A portion of the money thus received was also held by the Secretary of State for India for the purchase of silver and its shipment to India for the coinage of rupees.

The sale of Council Bills was one facet of the gold exchange system, and it continued so long as India had a favourable balance of trade. But in 1907-8, the balance of trade of the country turned unfavourable. There arose a demand for gold for export purposes. According to the recommendations of the Fowler Committee, the Government of India should have met this. But there was no gold in the gold standard reserve in India. First of all, it was given out of the paper currency reserve with some limitations. Then, it was decided that the Government of India would make weekly sales of a certain maximum quantity of sterling bills on London in this country at a fixed rate of 1*s*. $3\frac{29}{32}$*d.* These bills

Rate not allowed to fall by the device of reverse councils.

were known as reverse councils which completed the other side of the gold exchange standard. So long as they were available at 1*s*. $3\frac{29}{32}$*d*., the rate of exchange could not fall below, as nobody would have liked to have less than this amount for a rupee from anywhere else when this was available from the Government. On this particular occasion, the Government, however, sold these only up to a fixed extent every week, though till the date exchange strengthened. Later on, and specially when the rate of exchange showed a tendency to fall just after the out-break of the war, it sold these without any limit.

Mechanism of Gold Exchange Standard in India.

The mechanism of gold exchange standard in India consisted of the council bills and reverse councils on the one hand, and the gold standard and paper currency reserves and cash balances of the Government of India and the Secretary of State for India. The Council Bills were paid in India out of the rupee reserves held partly in the paper currency reserve, partly in the gold standard reserve and partly out of the cash balances of the Government of India. Reverse Councils were on the other hand, paid in London out of the sterling reserves held partly in the paper currency reserve partly in the gold standard reserve and partly in the London cash balance.

Q. 53. Explain the Gold Exchange Standard as it prevailed in India before 1914. Discuss its strong and weak points. (*U. P. 1941*)

No sanction for the gold exchange standard.

A. It must first of all be mentioned here that the Gold Exchange standard, as it prevailed in India before 1914, had no legal sanction behind it. The Fowler commission had rejected it and the report of the Chamberlain Commission giving a

sanction to it had not come out till February 1914.

Two currencies.

Description of internal and external currencies.

Inter-exchangeable at fixed rates.

Under this standard, India had two currencies, *viz.*, internal and external. Internal currency consisted of the notes issued by the Currency Department of the Government, rupee coins and subsidiary coins, and external currency consisted of the pound sterling, the currency of the United Kingdom. Both these currencies were inter-exchangeable at fixed rates. The Secretary of State sold Council Bills at 1*s.* 4$\frac{1}{8}$*d.* for a rupee to be delivered in India, and the Government of the country sold Reverse Councils at Re. 1 for 1*s.* 3$\frac{29}{32}$*d.* to be delivered in London. In fact, this was the way in which the exchange rate of the rupee was maintained between these two limits. The practice required the maintenance of huge balances both in India and London; and for this purpose there were Paper Currency and Gold Standard Reserves. The standard was truly speaking sterling exchange standard, but could also be called gold exchange standard, as sterling was then in parity with gold. This standard had both strong and weak points.

Maintenance of huge balances both in India and London necessary.

S. E. S. and G. E. S. both.

Strong points.

Exchange rate stable.

The most suitable media of circulation.

Let us first of all look to its strong points. The most important requirement of a sound monetary standard is that the currency of the country should have a stable exchange value. The rupee, as was pointed out by the Chamberlain Commission, had been firmly established; and the measures adopted for its maintenance had worked well in the crisis of 1907-8, the only occasion when they had been put to the severest test. Next, a country should have the most suitable media of circulation. In India, there

were rupee coins and notes, and these had served the purpose well. In fact, they constituted the most economical form of money also.

Weak points.

The standard had also certain weak points. One of them was artificial management of the whole system of currency and exchange. This involved, in fact, too much of Government interference and control. It also failed to inspire confidence of the public. The system, as was discovered during and after the war period, was also not proof against a rise in the value of silver. In framing it, this contingency had not been taken into account. Rupee melting point had, in short, not been considered at all.

Artificial management.

Lack of confidence.

Rupee melting point not considered.

Q. 54. Trace the causes of the breakdown of Gold Exchange Standard in India during the last Great War, and give a brief survey of the measures adopted by the Government to prevent an under appreciation of exchange. (*U. P. 1939*)

Exchange weakness.

A. **Causes of the breakdown of exchange and measures adopted.** As soon as the war broke out, there was a great demand for sterling and the rupee-sterling exchange rate showed weakness. But this was checked by offering drafts in India on London known as the Reverse Councils. Between Aug. 6, 1914, and January 28, 1915, they were sold to the extent of £ 8 million or so. This had a very good effect.

Sale of Reverse councils.

Rise in the exchange rate.

It was, however, at the end of 1916 that acute complications arose in the sphere of exchange.e Here are the causes of the same.

(1) *Favourable Balance of Trade.* Even before the War began, India had enjoyed a series of remarkably prosperous years. In fact, the successful working of the Gold-Exchange System was dependent upon the existence of a substantial balance of trade in India's favour. During the War also, and specially during the years 1916-17, 1917-18, and 1918-19, the average balance of trade in favour of India was greater than that of the three years preceding the War. This was due to the fact that supplies of food stuffs and raw materials were required for the use of allied powers, and the prices they realized were abnormally high. On the other hand, there was a contraction in imports as the productive power of the belligerents was more and more completely absorbed in war industries.

(2) *Exceptional Disbursements.* As India formed the base of important military operations in the eastern theatres of War, the Government of the country was called upon to provide funds for the payment of British and Indian troops engaged and for the expenses incidental to a modern campaign, and for civil expenditure in occupied territories.

(3) *Heavy Decline in Imports of Precious Metals*—Normally precious metals play an important part in the adjustment of our favourable balance of trade but during the war years there was a heavy decline in their imports due to the restrictions placed by belligerent countries on their exports and difficulties of transport.

Heavy demand for Council Bills.

These resulted in the strengthening of exchange and the heavy demand on the Secretary of State for issuing Council Bills. As

these were issued, the Government of India had to meet the demand for currency. The circulation of notes increased. But this could not go on to an unlimited extent as it would have endangered their convertibility. Price of silver had risen and its supply was not available. There was a very great demand for metallic currency. We should remember that so long as the price of silver did not reach 43*d.* for an ounce, there was no difficulty in selling Council Bills at 1*s.* 4*d.* and paying them in India in rupee coins or notes convertible into rupee coins. But the moment it reached that level it was not possible. In August 1917, the price exceeded 43*d.*, and it became necessary to raise the exchange rate also. Since then, it followed the price of silver and reached 2*s.* 4*d.* in December 1919 when the price of silver was 78*d.*

Increase in circulation of notes. **Demand for metallic currency.** **Melting point.** **Exchange rate raised.**

As pointed out by the Babington Committee, the inherent weakness of the Gold-Exchange system was that while it made provision against a fall in the value of rupee below 1*s.* 4*d.*, it made no provision against a rise in the value of the rupee above 1*s.* 4*d.* consequent on a rise in the price of silver. The rupee melting point, in short, had not been considered.

The inherent defect of the exchange standard became visible.

Q. 55. Examine the effects of the rise in the value of silver in 1914-18 on India's trade, industries, and the state. (U. P. 1941).

A. **The effects of the rise in the value of silver in 1914-18 on India's trade, industries, and the State.** The following were the effects of the rise in the value of silver in 1914-18 on India's trade, industries and the State.

Trade. The rise in the price of Silver to

43*d.* and upward for a standard ounce necessitated the raising of the rupee-sterling exchange rate in an exact proportion. Had this not been done, the intrinsic value of the rupee would have become greater than its exchange value, and as a consequence, the rupee would have disappeared from circulation, or been melted down or exported. One of the results of this rise in the rupee-sterling exchange rate was to check the already rising level of prices in the country from rising still further. No doubt, there were certain other factors such as Government control over the movement and prices of certain commodities in the country and restrictions on finance and freight which did it. But this also had its own influence. As is always the case, the check in the further rise of the price level somewhat cut down the profits of the traders but this did not mean in any way lesser activity in the market because the general price level was too high to result in any such thing. On the other hand, there were some commodities whose prices were not at all affected by changes in foreign exchanges. The question of effects on their trade, therefore does not arise at all. But there is one thing which must never be lost sight of. It is that changes in exchange rate in themselves bring about dislocation of trade. This, of course, could not be avoided, Much difficulty did arise due to uncertain conditions. Finally, rising exchange did bring about adverse effects on the export of commodities not required for carrying on the war, though the business in them had already been reduced to the minimum by the difficulties of transport.

Rise in the exchange rate checked the already rising level of the prices.

Profits cut down but general price-level being high no fall in trade.

Dislocation of trade.

Export trade a little discouraged.

Industrial progress not checked.

Industries. As regards the effects on industry, we find that it was already making much progress due to the impetus given to it by war. The check in the rise of prices was, therefore, again too slight to have any effect upon it. But there were certain commodities, whose production had not obtained any impetus due *to war. Their prices too, were, however, not at all affected by the rise in the exchange rate,* and hence the question of the effects on the rise in the value of silver does not arise in their case as well.

Gain in the remittance of Home Charges.

The State. The effects on the State were, however, of a far reaching consequence. First of all, there were home changes amounting to £25 million a year. The net burden of the remittance of these upon the Government fell with every rise in the price of silver. This was a gain to the state. But it was only incidental. In other ways, it was placed in difficulties of an unprecedented nature. Demand for rupee currency had risen, and silver could be purchased only at very high prices. This involved it in much trouble. Council Bills could not be sold at 1s. 4⅛*d.*, the official rate. The Secretary of State in the beginning declared his intention to maintain it by placing a restriction on their sale, but later on under the pressure of continually rising prices had to give up the attempt. This led to the breakdown of the monetary standard whose cause had so much been championed in the past. As rupee currency could not be supplied according to the demand, measures had to be adopted to discourage its use. Besides, other forms of currency were brought into circulation. There

Difficulties

(i) Demand for rupee currency.

(ii) Council bills could not be issued.

Break-down of G. E. S.

Rise of rupee currency discouraged.

was the fear of the dissipation of rupee coins by export or melting. Hence, its use for other than currency purposes was made illegal. Facilities for the encashment of notes at the District Treasuries had also to be withdrawn. It was, in fact, the timely delivery of Pittman silver from U. S. A. that saved the notes from becoming *inconvertible*.

Facilities for encashment of notes withdrawn.

Pittman silver.

Q. 56. What difficulties did the Indian Currency and Exchange experience during the Great War? How were they met? (Calcutta, 1937).

A. **Difficulties experienced by the Indian Currency and Exchange during the Great War.** The difficulties experienced were temporary and permanent. Temporary difficulties extended up to the completion of 1916, while permanent difficulties extended up to the year 1919.

Temporary difficulties. Temporary difficulties consisted of the weakening of exchange, withdrawal of savings bank deposits and bank deposits, a demand for the encashment of notes, and a run on Indian gold stock.

Four.

Permanent difficulties. While temporary difficulties arose due to a panic caused by the outbreak of the war, permanent difficulties were brought about by a rise in the value of silver. The latter were, of course accentuated because of (1) a continued and increasing favourable balance of trade, (2) exceptional disbursements, (3) heavy decline in imports of precious metals and (4) absorption of rupees.

Due to a rise in the price of silver.

Ways in which these difficulties were

met. The following were the ways in which these difficulties were met.

Reverse councils.

(1) Weakening of exchange was set aright by *issuing reverse councils. Between 6th August, 1914 and 28th January, 1915, they were sold to the extent of £ 8,707,000.* In February, 1915, demand for council bills revived. But, there arose a slight weakness again in 1915-16 and between November 1918 and April 1919. But this was tide over on these two occasions as well by the sale of reverse councils.

Withdrawals met in full.

(2) Withdrawals from savings bank and bank deposits were also met in full and this had the effect of restoring confidence in them in the end.

Payment of notes encouraged their circulation.

(3) Initial demand for the encashment of notes also having been met in full, their active circulation soon began to rise. From about Rs. 43·96 crores at the end of 1914-15, it rose to about Rs. 153·78 crores by the end of the year 1919-20.

Offer of gold stopped.

(4) Demand for gold in exchange for notes was also tried to be met by the Government at first, but soon it was felt that this was not possible, and its offer to private persons was suspended.

Sale of Council bills limited.

(5) When because of a continued and increasing balance of trade, demand for council bills increased in London, the Secretary of State for India had to put a limit to their sale, or else convertibility of notes which were issued in their payment in India would have been endangered. This, however, resulted in a divergence between the market rate of exchange and the rate at which the bills were sold. Next, the bills were sold only to the importers of materials necessary for the prosecution of war.

(6) When the price of silver rose above 43*d*. per ounce, it was not possible to sell council bills at 1*s*. 4⅛*d*. and make the payment in rupee coins which cost more than this sum. As notes were convertible into rupees, payment could not be made in notes as well. There was always a need for the maintenance of a sufficient amount of rupees for their encashment. Hence, the rate of exchange at which council bills were sold was raised with a rise in the prices of silver. **Rate of exchange raised.**

7. To meet the demand for rupees, the Secretary of State for India purchased silver for coinage. But the demand was so enormous that the ordinary market could not satisfy it and an approach had to be made to the Government of U. S. A. for a sale of silver. It was the timely arrival of this silver which enabled the Government to avert a serious currency crisis in this country. **Pittman silver.**

8. With a view to avoid competition of the Secretary of State with Indian public in purchasing silver in foreign markets, import of silver into India on private account was prohibited. **Import of silver prohibited.**

9. The shortage of silver led the Government to acquire and use gold. An ordinance issued in 1917, required all gold imported into India to be sold to the Government at a price based on the sterling exchange value of the rupee. A branch of the Royal Mint was established in 1918. Pending the establishment of the Mint, gold mohur, a 15 rupee coin of the same weight and fineness as sovereign, was minted. The branch of the Royal Mint was, however, closed in 1919. **Acquisition and use of gold.**

10. After the armistice, on the removal of war time restrictions on the export of gold from **Gold made available.**

belligerent countries, the Government of India bought it in London, U. S. A. and Australia, and made it available to the people.

Use of coins for non-monetary purposes forbidden.

11. Silver and gold coins had begun to fetch a higher value as metal than as coins. Hence, their use *for purposes other than currency was declared illegal. Their melting and exporting was also* declared illegal.

Economy of silver.

12. With a view to economise silver, eight anna, four anna and two anna pieces were made of nickel instead of silver, and Rs. 2½ and Re. 1 notes were issued to supplement rupee coins.

Increasing note-issue.

13. In spite of the run for encashment of notes, made from time to time, their gross circulation went on increasing.

Increasing fiduciary issue.

14. On the commencement of the war, the fiduciary issue amounted to Rs. 14 crores. But by the end of the year 1919, it had reached the stupendous figure of Rs. 120 crores. Restrictions were imposed on their encashment as well, and the result was a small discount or butta on them in many parts of the country.

Financial measures.

15. Measures were taken to keep down the expenditure of the Government. Additional taxation and borrowing was also resorted to. Post office cash certificates were introduced for the first time.

Q. 57. Briefly explain how the Indian currency system was affected by the Great War, and what steps were taken to meet the situation?

(Calcutta 1939).

A. This question can be solved with the help of the answers to Qs. 53 and 55.

Q. 58. Explain the working of the Indian currency system just before the Great War.

(Rajputana).

S. E. S., the basis. **Same as G. E. S.** **Two currencies.** **Their description.**

A. The working of the Indian currency system just before the Great War. The *Indian currency system just before the Great War was based on sterling* exchange standard. *But* as sterling was in parity with gold, it could be called gold exchange standard as well. Under this standard, there were two currencies, *viz.*, internal and external. Internal currency consisted of notes and rupee and subsidiary coins, all issued by the Government of India, and external currency consisted of the sterling. Notes were backed by a reserve known as the paper currency reserve which could be held in rupees, and gold coins and bullion either in India or London, and to a limited extent, known as the fiduciary portion, in rupee and sterling securities. They were convertible in rupee coins. The whole of the internal currency was, on the other hand, convertible into external currency, and *vice versa.*

Device of issuing council bills and reverse councils. **Payment out of reserves.**

For a conversion of internal currency into external and external into internal, a device of issuing sterling bills in India on London and rupee bills in London on India was adopted. The former were known as the reverse councils and the latter as council bills. By issuing the council bills the rate was checked from rising above $1s.\ 4\frac{1}{8}d.$ and by issuing the reverse councils it was checked from falling below $1s.\ 3\frac{29}{32}d.$ The council bills were paid in India out of the paper currency and gold standard reserves and cash balances of the Government of India, while the reverse councils were paid in London out of the same held

there. Gold standard reserve was created and maintained out of the profits on the coinage of rupees.

Merits.

The system, of course, worked well and was *beneficial to India. It had supplied suitable media for internal circulation, provided means for a* settlement of the balance of trade, secured stability between rupee and sterling, and prevented a fall in the value of rupee below 1*s*. 4*d.*

No proof against a great rise in the value of silver.

But it was not a proof against a great rise in the value of silver as was brought to light subsequently. In framing it, this contingency had not been taken into account. Hence, when the unexpected happened, it threw the currency system out of gear.

Q. 59. In what circumstances was the gold value of the rupee fixed at two shillings? What were the effects of the adoption of this ratio? (Rajputana).

A. Circumstances leading to the establishment of the rupee at two shillings. When the price of silver rose during the war above 43*d.* per ounce it was not possible to sell Council Bills at 1*s*. 4⅛*d.* which was the normal rate of exchange at which the Secretary of State for India sold them, as their payment in rupee coins which cost more than this sum could not be possible. As notes were convertible into rupees, payments could not be made in them as well. There was always a need for the maintenance of a sufficient amount of rupees for their encashment. Hence, the rate of exchange at which council bills were sold was raised with a rise in the value of silver, and had reached in May 1919 when Babington Smith Commission was appointed near

Council bills could not be sold at 1s·4 1/8d.

Rate raised.

about 1*s*. 8*d*. During the period, the commission carried on its investigation, it rose still higher and reached the level of even more than 2*s*.

The majority of the commission thought that the price of silver was bound to continue to be high, and if rupee was to be fixed at a higher ratio, it would continue to be a token coin and thus enable the Government to control and regulate the amount of currency in circulation.

Price of silver would continue to be high.

It also thought that the existing rate was high and if it was lowered, there was bound to be caused a rise in prices which would, in its turn, cause hardship to the poorer classes.

Rise in prices expected in consequence of a fall in exch. rate.

Besides, a high ratio was advantageous to Indian producers, as it was expected to keep the cost of materials and machinery down in terms of rupees.

High ratio advantageous to producers.

A high rate was not expected to discourage exports as well, as the world shortage of raw materials and foodstuffs was expected to continue and give India a monopoly in its trade.

Not expected to discourage exports.

Government finances were also bound to gain enormously on account of a high rate by a saving in the remittance of home charges.

Gain to Govt.

Hence, rupee was established at two shillings.

Effects of the adoption of this ratio. As soon as this rate was adopted, a number of factors came up which tended to bring about a fall in it. But the Government made serious efforts to maintain it. It sold reverse councils at rates determined by the fall in the value of sterling in terms of gold less expenses for the shipment of gold. But, later on, finding that the rate could not be maintained at 2*s*. gold, it tried

Efforts to maintain at 2s. gold and then at 2s, sterling failed.

to maintain it at 2s. sterling. After sometime this also had to be given up. Besides the sale of reverse councils, the Government continued the sale of gold. It also tried to contract currency with a view to raise the exchange value.

Exch. left to itself.

Finally, the sale of reverse council was stopped. Left to itself, the exchange adjusted according to the forces of supply and demand.

Loss to Indian Exchquer.

The sacrifices involved in the attempts to raise the exchange rate were enormous. Reverse councils were paid in London out of the sterling securities and Treasury Bills which had been acquired at Rs. 15 for a pound but were sold at Rs. 10 to Rs. 7 per pound. *The difference was a heavy loss by the Indian Exchequer. It amounted to about Rs. 40 crores.* The collapse of exchange was critical for importers many of whom had ordered for goods when exchange was high without fixing for their exchange and were unable or unwilling to settle at the low rate when the goods arrived.

Critical for importers.

Exporters suffered.

Exporters found themselves loaded with produce for which there was no foreign demand. Prices went down in the country and they had to suffer. Besides, deflation of currency brought the people in difficulty. In the first place, it made the money market tight and raised the bank rate of interest on loanable money, and in the second place, it tended to lower down the already lowering down prices. Company promoters did not get capital, the already existing concerns did not get market for their produce, and the agriculturists, could not realise, in many cases, even their cost of production.

Results of deflation.

Conclusion.

In short, it may be said that the effects of the adoption of a two shillings ratio were contrary to

what the majority of the Babington Commission had thought.

Q. 60. What were the recommendations of the last Royal Commission on Indian Currency and Finance and how far have they been given effect to ? *(Rajputana)*

A.

RECOMMENDATIONS OF THE HILTON YOUNG COMMISSION

Gold Bullion Standard. Hilton Young Commission recommended Gold Bullion Standard for India. The Currency authority was *for this purpose to be obliged to buy and sell gold bars at rates determined by the fixed gold parity of the rupee and in quantities of not less* than 400 fine oz. (*i.e.*, 1065 tolas). No limitation was to be imposed as to the purpose for which gold was required. But they stated that in the case of India there was a difficulty in the way of imposing this obligation in this form. She demanded gold both for monetary and purely social uses, and this latter was to be seriously taken into account. It was essential, therefore, that the conditions which were to govern the sale of gold by the currency authority were to be so framed as to free it in normal circumstances from the task of supplying gold for non-monetary purposes. This, then, was to be the limitation in the case of India.

Difficulty in India

Normally gold not to be supplied for non-monetary purposes.

Subsidiary recommendations in this connection. A number of other recommendations were made as a result of the adoption of the Gold Bullion Standard. These were :—(1) The Sovereigns were demonetised. (2) Gold saving

certificates redeemable in three or four years and yielding interest to one who bought it were to be issued. (3) New notes were to be issued convertible into gold bars and not in silver rupees. The old notes were to continue to be converted into silver rupees. (4) The coinage of the rupee was to be stopped until the rupees in circulation were reduced to the amount required for small change. (5) One rupee notes were to be re-introduced but were not to be convertible by law into silver rupees. (6) Both the Gold Standard and Paper Currency Reserves were to be amalgamated and the proportions and composition of the combined reserve was to be fixed by law. They laid down that gold and gold securities were to form not less than 40 per cent. of the total.

Reserve Bank of India. The second principal recommendation of the Commission was regarding the authority controlling the working of the standard. This was to be the Reserve Bank of India.

Transfer of note issue.

The note-issue business was to be transferred to it from the hands of the Government. It was to be a banker's bank.

Banker's Bank.

All the banks were to maintain with it a balance to the extent of 10% of their demand liabilities and 3% of their time liabilities. It was to rediscount the bills of its member banks at its bank rate announced weekly. It was also to purchase and sell foreign exchanges.

Foreign exchange.

The bank was also to act as a government bank.

Government Bank.

A number of restrictions were recommended to be imposed upon the bank. There were also certain recommendations with regard to the constitution etc., of the bank.

Exchange Rate. The third most important

recommendation was regarding the rate of exchange. It was to be fixed at 1*s*. 6*d*. gold. 1s. 6d.

Steps taken on the recommendations. The first fruits of the recommendations was the passing of the Currency Act, 1927. It embodied merely those measures which were for the transitional period—the period upto the date of the passing of another Bill, *viz*., 'Gold Standard and Reserve Bank of India Bill.' But this was dropped later on The clauses of the Act were (1) the ratio was fixed at 1*s*. 6*d*. gold or 8·47512 grains of gold for a rupee, (2) Sovereigns and half-Sovereigns were demonetised, (3) it imposed for the first time upon the Government a statutory obligation, (*a*) to purchase gold bullion tendered by the public for sale in the form of bars containing not less than 40 tolas of fine gold at the rate of Rs. 21-3-10 per tola of fine gold (*i. e*., at 1*s*. 6*d*. = Re. 1), (*b*) to sell to any person who made a demand on that behalf, gold for delivery at the Bombay Mint at Rs 21-3-10 per tola of fine gold or, at the option of the Controller, sterling for immediate delivery in London at an equivalent rate, provided that no person was entitled to demand an amount of gold or sterling of less value than that of 1065 tolas of fine gold.

Currency Act 1927.

Sovereigns demonetised.

Purchase and sale of gold or sterling.

In September 1930, U. K. abandoned gold standard. India had also to do the same. Since then, we have purely sterling-exchange standard.

S. E. S.

In 1934, Reserve Bank of India Act was passed. In 1935 the bank was established. With the establishment of the Reserve Bank of India, note-issue business was transferred from

Establishment of R. B.

the hands of the Government of India to those of the bank. On this date, two reserves were unified. The composition of the Paper Currency Reserve is as had been laid down in the Act. Gold coins, bullion and sterling securities form 40 % of the total according as was recommended by the Commission. The Reserve Bank is a Government bank as also the banker's bank. Scheduled banks have to maintain a deposit of at least 5 % of their demand liabilities *and 2 % of their time liabilities. The bank is also under obligation to purchase and sell sterling at fixed* rates.

Composition of the P.C.R.

Government and banker's bank.

Purchase and sale of sterling.

Q. 61. Discuss the reasons which led the Hilton Young Commission to recommend gold bullion standard for India. (Allahabad, 1941)

A. **Reasons which led the Hilton Young Commission to recommend gold bullion standard for India.** The standards alternative to gold bullion standard were (1) sterling exchange standard, (2) gold exchange standard and (3) gold currency standard. The first two were rejected by the Commission on general grounds*. The objections to gold currency standard were the following :—

S. E. S. and G. E. S. rejected on general grounds.

(1) A large extra demand for gold from India would cause increased competition for gold among the countries of the world and lead to a substantial fall in gold prices and a substantial curtailment of credit.' Credit is based upon gold and a fall would cause a shortage.

Shortage of gold.

The students may here state the general grounds (1) lack of simplicity, (2) Absence of confidence (3) Unautomatic character, and (4) inelasticity. In the case of sterling exchange standard; there is also the defect of the dependence of one currency upon the other.

(2) The actual demand for gold cannot be estimated. It is possible that the people may begin to prefer gold coins to notes. The fear in the fall in the status of rupee may also cause their conversion into gold coins.

Actual demand for gold cannot be estimated.

(3) The fall in the demand for silver because of the adoption of a gold currency standard would reduce its price. This would involve a loss to the Indian Exchequer on the sale of the surplus silver. Further, it would lower down the value *of savings of the poorer Indian people who invest them in silver ornaments.*

Fear of a fall in the value of silver.

(4) Adoption of gold currency standard by India might lead to demonetisation of silver by China as well. This would raise the price of gold and thus result in the difficulties mentioned in (1). Further, it would also reduce the price of silver and thus raise the difficulties mentioned in (3).

Abandonment of silver standard by China feared.

(5) India would not get gold without the co-operation of Great Britain and U. S. A., and these countries are against the adoption of gold currency standard by India.

Great Britain and U. S. A. opposed.

(6) The scheme would prove costly. It might mean Rs. 3 crores a year for about 10 years.

Costly.

Then, there were certain other general objections.

(7) Gold in circulation is expensive, while gold in reserve is more useful for bringing about stability in exchange.

Gold in reserve better.

(8) Gold currency standard is a sign of backwardness. Many countries returning to gold standard after the war did not return to its gold currency form.

Gold currency sign of backwardness

(9) The bulk of transactions in India involve

Small payments. small payments and hence gold in circulation not required for them.

Q. 62. Write a short essay not exceeding four pages of your answer-book, on Indian Currency since 1931 (September). (U. P. 1941)

Indian Standard gold bullion-cum-sterling-exchange.

A. U. K. went off the gold standard on September 21, 1931. The monetary standard of India, since the *passing of the Currency Act, 1927, had been gold bullion cum sterling exchange standard, as it had been made by that act obligatory upon the currency authority to purchase gold and sell gold or sterling from or to the public at fixed rates and in not less than fixed minimum quantities.* With the U. K.'s going off the gold standard, it became necessary for the Government of India to decide whether it would continue the sale of gold or of sterling at the fixed rate. Only one could be so sold as there existed no longer a fixed parity between them. But the decision had to be postponed so long as the instructions were not received from the Secretary of State with regard to it. An Ordinance was, however, promulgated, on the same date prohibiting the sale of gold and sterling by the Currency Authority at the statutory rate. A bank holiday for three days was also declared to avoid speculative dealings in exchange. Finally, when matters had been settled, on September 24, another Ordinance was promulgated to declare the intention of the Government to maintain the ratio at 1*s.* 6*d.* sterling and not gold. This was a clear departure from both what had been recommended by Babington Smith Commission and Hilton Young Commission. As there was a fear of the causing of undue strain by the public on the gold and sterling resources

Whether gold bullion or sterling.

Secretary of State's decision awaited.

A temporary ordinance.

Permanent ordinance sterling-exchange.

of the Government of India and export of capital abroad, it was also announced at the same time that sterling would be sold only to the recognised banks for financing normal trade requirements and contracts completed before September 21, 1931. The control was to be exercised through the Imperial Bank.

Fall of the rupee in terms of foreign **exchanges and gold equal to that of the sterling, and high gold price and its export.**

One effect of this linking of the rupee *with the sterling was that with the depreciation of the latter in terms of the other foreign currencies and gold, the former also depreciated to the same* extent in their term ; and the price of gold rose in this country very high. This led to the export of the yellow metal in huge quantities. The restrictions on the sale of sterling thus becoming unnecessary, the announcement to this effect was withdrawn in 1932. The export of gold continued uncontrolled since then till recently when due to the outbreak of the present war it was controlled by the Government.

Export of gold contd.

S. E. S. legalised temporarily.

When the Reserve Bank of India was established, the question of the standard of value for the country again assumed much importance. What the Government had been practising since 1931 was regularised and made statutory by the Reserve Bank Act 1934. It was stated that in the existing state of monetary disorganisation in the world, no such standard could be devised as would be more stable and permanent. Indian opinion, on the other hand, undoubtedly regarded the question of monetary standard as one requiring immediate attention. It was argued that the existence of a suitable monetary standard was a pre-requisite to the success of banking in a country. Depreciation of the rupee in terms of sterling was also regarded necessary in order to put the foreign

Indian opinion wanted a permanent solution.

Depreciation of the rupee in terms of sterling demanded.

trade of the country on a sound basis. No doubt it had depreciated in gold, but the fact was that it had remained overvalued in terms of sterling. As against this other foreign currencies had been devolved in its term. Another criticism was that the export of gold was allowed to continue without any restriction from the side of the Government. In fact, since 1931, almost all the speeches and writings in connection with the currency policy of the Government had till the outbreak of the present war centred round the questions of devaluation of the rupee and export of gold.

'Restriction on gold exports demanded.

The present essay will not be complete without the mention of a very important change that has been brought about in the currency system of the country with the establishment of the Reserve Bank. It is that since it has come into existence, the note issuing authority has been transferred to it. There have also been certain minor changes in the constitution of the Paper Currency Reserve.

'Bank issue of notes.

Changes in P. C. R.

Q. 63. When and why did India adopt sterling exchange standard? Name the authority responsible for its maintenance, indicating the methods adopted by such authority for this purpose. (*U. P. 1937*)

A. **When adopted?** Sterling-exchange standard was first adopted in India during the first decade of the twentieth century. But so long as sterling was in parity with gold, there was no difference between this standard and the gold-exchange standard.

First decade of 20th century.

Why adopted? As regards the question why did India adopt this standard, let us refer to

Force of circumstances. *Never adopted deliberately.*

what the Chamberlain Commission pointed out in this connection. According to them, force of circumstances compelled the Government to evolve a new system, which was contrary to one sanctioned by the Fowler Committee. The system, as they stated, had never been deliberately adopted as a consistent whole, nor did the authorities themselves appear to have had a clear idea of the final object to be attained. To a great extent this system was the result of a series of experiments.

Council bills introduced. *Its initial advantages.* *Transhipment charges saved.* *Use extended.* *Rate checked from rising above 1s. 4 1/8 d.*

How adopted? Normally India has a favourable balance of trade. The Secretary of State, taking advantage of the same, introduced in 1898, the practice of selling the council drafts for gold in London, and issuing notes against such gold in India, with a view to meet what are known as Home Charges. This was advantageous in two ways: (1) a part of the favourable balance of trade of the country was liquidated without gold being transferred, and (2) Home Charges were met without the Government of India having to send gold from the country. In short this saved, in the first place, the transhipment charges of individuals and then again those of the Government of India. By and by it began to be realised that the practice could be extended with advantage for keeping a part of the paper currency reserve in London in order to purchase silver there for transhipment to India for coinage purposes, and consequently since 1904, the offer for the sale of council bills was kept open without limit (*i. e.*, over and above the requirements of the Secretary of State). In this way the rupee-sterling rate did not rise above 1s. $4\frac{1}{8}d.$—the price at which council bills were sold.

Fowler Committee.

In pursuance of the recommendation of the Fowler Committee, the Government of India proposed the formation of a special reserve out of the profits on rupee coinage in September 1900. The idea was to keep the reserve in gold locked up in a special chest in India. But the Secretary of State decided that it should be remitted to London and invested in sterling securities. This provided a further opportunity of transfering funds from India to England and thus facilitating the issue of council bills to any extent.

Invested in sterling securities.

During the crisis of 1907-8, however, India's balance of trade turned unfavourable, and there was a demand of gold for export to England.. This was not met in full with the result that the rate of exchange declined. Since 26th March, 1908, however, weekly sales of sterling bills on London (reverse council) began to be made in India at a fixed rate of 1*s.* $3\frac{29}{32}$*d.* The securities in the gold standard reserve were realized to meet these bills in London. They continued to be sold freely in this country until (on 11th September, 1908) the exchange appeared to have been strengthened.

Reverse councils issued for the first time and exchange strengthened.

Thus the rupee was established. It was clear that it could be checked from rising above and falling below a certain point by issuing council bills and reverse councils with the help of the two reserves.

Achievement.

Chamberlain Commission in its findings approved of the standard. It, however, broke down during the War because as the Babington Smith Committee pointed out, there was an inherent weakness in it, *viz.*, that while it made

Approval given by Chamberlain Commission.

provision against a fall in the value of the rupee below 1*s.* 4*d.*, it made no provision against a rise in the value of the rupee above 1*s.* 4*d.* consequent on a rise in the price of silver. The rupee melting point, in short, was not considered.

The Babington Smith Committee drew a distinction between gold exchange standard and sterling-exchange standard and recommended the former. The Government of India, however, could maintain neither for sometime. Since 1924, it maintained the parity of the rupee with sterling till the latter came in parity with gold. But in the year 1931 again, when the sterling was divorced from gold, rupee had again to follow sterling. Since then, we have sterling-exchange standard. It was quite contrary to what was recommended by the last Currency Commission and the authority responsible for the departure was the Secretary of State.

G. E. S.

S. E. S.

At present no reserve is kept in England. The Reserve Bank of India, however, maintains the exchange rate by the contraction and expansion of currency. It uses its sterling resources and power to issue notes for this purpose.

R. B. maintains it.

Q. 64. Outline the origin, functions, and the present position of the Indian Gold Standard Reserve. (*U. P. 1936*)

A. The gold standard reserve was established in 1900. The Fowler Committee had recommended that the profits on the coinage of rupees should be set apart and kept in gold as a special reserve in India. The principal use of the gold reserve, as laid down by them, was to make it available for foreign remittance whenever the exchange fell below specie point.

Fowler Committee recommended it.

Method of performing the function was changed.

Stoppage of the offer to sell council bills restricted the supply of Indian currency.

Reserve used to meet Home charges.

Sale of Reverse councils and its effects.

Rate of exchange strengthened and unfavourable balance of trade was liquidated.

Summary of the functions.

Functions. But as soon as the reserve was established, the profits on coinage were remitted to London and invested in securities, and since then although the original purpose remained the same,, the method of performing its function changed. In case there was an unfavourable balance of trade in the country, and exchange tended to fall below the specie point, the Secretary of State stopped issuing council bills and thus an addition to Indian currency was checked. This had the desired effect of raising the value of the rupee by restricting its supply. At such times, if the Secretary of State needed funds in London, he could fall back upon the reserve. Again, the Government sold reverse councils here on London. The effect of doing this was that the internal currency being withdrawn from circulation its value in terms of sterling tended to rise. Thus besides strengthening the rate of exchange, it also liquidated the unfavourable balance of trade, as importers of commodities purchased reverse councils and sent them to their creditors in London who got payment in gold from the gold standard reserve on presentation of the same to the Secretary of State. Thus it served three purposes, namely, (1) the strengthening of the exchange rate, (2) liquidation of the unfavourable balance of trade, and (3) the meeting of Home charges'.

Gold not kept in India.

Invested in securities in London.

Position. We have seen that the Fowler Committee recommended the reserve to be kept in India in gold, but this was not done. Instead it was transferred to London and invested in securities. In 1906, however, came a change. The difficulty in meeting the demands for rupees led to the formation in India of a

special reserve for this purpose outside the paper currency reserve. This was to be in coined rupees and was to form a part of the profits on the coinage of rupees. Thus two branches of the reserve were formed, (1) the London branch and (2) the Indian branch in the form of rupees.

Rupee branch established.

In 1907, on the recommendation of a Committee, known as the Mackay Commitee, appointed by the Secretary of State to consider the question of Indian Railway finance, a sum of more than a million pounds was transferred from the Reserve to the provision of rolling stock and other improvements for Indian railways. It was also decided that for the future one-half of any profits on the coinage of rupees would be transferred for this purpose until the gold standard reserve reached £20 million. It was apparently contemplated that after the total had been reached, all profits on silver coinage would be diverted from the reserve. But a serious crisis occurred in the year following, and the decision had to be changed. The reserve was hard hit by this crisis. In all more than £8½ million were withdrawn from the reserve to meet the reverse councils for strengthening the exchange value of the rupee. There was much public criticism on the location and composition of the reserve. The Chamberlain Commission appointed to give its opinion on the same decided many of the points. Firstly, it recommended that no limit was to be placed on the total reserve and the profits on coinage of rupees were to be exclusively credited to it. In addition they recommended that (1) a much larger portion of the reserve be held in actual

A limitation to reserve.

Crisis and criticism.

Recommendations of Chamberlain Comm on.

gold, (2) the Indian branch of the reserve in which rupees were held be abolished, and (3) the most suitable place for location of the reserve was London. These recommendations were accepted and given effect to with the only exception that during and after the War the reserve was held chiefly in securities. The recommendations of the Babington Smith Committee were also to the same effect as that of the Chamberlain Committee with the only exception that it considered the holding of a portion of the gold in the reserve in India as necessary in order to inspire confidence in the public. In the years that followed the amount of the reserve mounted upto more than £40 million, at which figure it was kept till its unification with the paper currency reserve on the establishment of the Reserve Bank of India as proposed by the Hilton Young Commission.

B. S. Committee.

Unification with P. C. R.

**Q. 65.* *Account for the unusual export of gold from India at the present time. Has India benefited by it?* *(Rajputana)*

A. **Causes of the gold export.** India had gold bullion or exchange standard till 1931. In September of this year, U. K. went off the gold standard. The Secretary of State for India decided that thenceforth Indian currency would also be not exchangeable with gold, but instead it would be exchangeable with sterling. The result was that as sterling fell in terms of gold, rupee also fell in terms of the same. Till September, 1931, mint price of a standard oz. of gold was £3. 17*s*. 10½*d*. in U. K. Since then it

Adoption of sterling exchange standard.

*The question and the answer need change in the light of present conditions.

has been rising and at present it is about £8. 8s. Similarly, the price of gold has also risen in this country from about Rs. 21·4 per tola to about Rs. 42 per tola. As the price of gold rose, it was natural for the people to sell it in large quantities. Gold is being sold, therefore, firstly as it is profitable to do so at the present price, secondly because the people of the country, not being able to meet their current expenses out of their current income, are forced to fall upon their hoards. This is due to the effects of the 1s. 6*d*. rate.

Sales profitable.

Its effects. One view is that the present gold export is beneficial to the country in a number of ways. *First of all*, people have sold it at a profitable rate. *Secondly*, their holdings have now been transformed into money which they can invest in industries. *Thirdly*, the Government was enabled from 1931 to 1937 to buy sterling and build up decent balances in London. This has been good inasmuch as it has enhanced the credit of the country in the eyes of the foreigners. *Fourthly*, since 1937 it has enabled the authorities to maintain the exchange ratio which would have tumbled down in its absence. *Finally*, there are people who believe that the price of gold is sure to fall in the near future when the important countries of the world realise that they have been paying too high a price for a metal which has no use. In fact, the monetary use of gold has now been reduced to the single function of a corrective to exchange fluctuations through the agency of exchange equalisation funds. But this, again, is not necessary now. The managers of the funds in every country have come to realise that ex-

Advantages claimed.

change fluctuations can be mitigated by other and less costly *means and processes e. g., by purchase and sale of foreign securities. Under the circumstances, if they have not yet renoun*ced the use of gold, it is because they realise that in the event of depreciation of gold, their own stocks of gold would become worthless. U. S. A., England and France are thus the only countries having interest in the future of gold at present. How long these countries would be able to keep up the price of the metal under the circumstances is a question, we cannot answer. But this much is certain that the under current of events indubitably point to a depreciation of gold. If it is so, the present export of gold from India is very desirable because a poor country like it cannot afford to allow its accumulation of precious metals to freeze in its own hands.

Possibility of its becoming frozen.

Dis-advantages.

But there is another view which holds that gold exports are detrimental to the interests of the country. It is pointed out that Indian currency itself is a depreciated currency, and holdings in it are sure to freeze away. Besides, we have no confidence in the sterling too and it is just possible that it may also lose its value. Then, statistics show that no appeciable development of industries has been brought about in this country during this period. This is due to the economic policy of the Government. The high rate of exchange whose maintenance in recent years has been made possible because of the gold exports, is also not desirable for the country.

Conclusion.

As a conclusion, it may be said that gold

exports are in themselves not detrimental. But *they have been so because their proceeds have not been used up for the benefit of the country. It has rather been squandered away uselessly* and the currency of the country in which we hold it, is also not stable and may deprecite in value at any time.

Q. 66. Trace the economic effects of the export of gold from India in recent years.

(Calcutta, 1939)

A. An answer to this question can be given with the help of the answer to Q. 65.

Q. 67. Contrast the effects of gold imports and exports upon the economic system of India, as shown by her actual experience (Calcutta, 1940)

Imports before 1931 and exports since then.

A. **Introduction.** India imported gold and silver almost every year prior to 1931 because of the character of her balance of trade. But since the year mentioned, she has been exporting them. We shall, however, look herein to the effects of exports and imports of gold alone.

Causes of India's becoming a sink for gold.

Effects of the imports of gold. Gold had been demonetised in 1835. Mints were, of course, open to its free coinage up till 1893, but gold coins, not being legal tender, could not form an important part of the currency in circulation. In 1893, mints were also closed for its free coinage and after this action of the Government, there was lost even the little chance it had for coming into circulation. Under the circumstances, all gold imported into the country went into hoards, and India has been aptly described as a sink into which it flowed never to return. The effect of this was a shortage of capital in the country, and hence backwardness of the industries. Whatever

Result discouraging for industries.

industries have been developed, they have been *developed with* the help of the foreign capital.

Effects of the exports of gold. In the year 1931, gold began to be exported out of the country, and it has not ceased even with the outbreak of the war. The first question in this connection is whether it is 'distress gold' or 'investment gold'. Truly speaking it is both. Gold has been sold to make both ends meet, as far as poor *people are concerned. But it has been sold to take profit as far as rich people are concerned. Gold exports enabled the country prior to the outbreak of the present war to maintain a favourable* balance of accounts. They enabled the Government to obtain large quantities of sterling and pay off the sterling debt. They enabled the Government to meet home charges as well. The credit of the Government was improved because it could pay the debts even when other countries were making defaults. This also enabled it to raise new loans on reduced rates of interest. A decreased quantity of gold enabled the Government to cancel the sterling debt which had been accumulated at a time when more of gold would have been required to pay it off. The position of the reserves (gold standard and paper currency) was strengthened. They also helped the maintenance of the 1*s.* 6*d.* rate. Besides, they stimulated the foreign trade of the country by increasing the purchasing power of the people of the countries importing them. They also allowed the sellers of gold to get higher prices which they used in tiding over financial difficulties. Those using the proceeds for investment purposes supplied capital to Indian industries.

Gold both distress and investment.

Balance of accounts favourable.

Acquisition of sterling and its uses.

Improvement in credit and its effects.

Saving of gold in debt payments.

Position of reserves strengthened.

Ratio maintained and other advantages.

On the other hand, it is said that India has

been parting with a precious metal. It is doubtful if King Gold has been dethroned for ever. If this is not so, it would be difficult for India to acquire it. **Loss of a precious metal.**

APPENDICES

I

SHORT NOTES

Gold Standard Reserve. *A note on the same can be prepared from the question dealt on this topic in Chapter VII.*

Ad hoc securities. *Babington Smith* Committee recommended a two shilling rate. This necessitated the re-valuation of sterling securities in paper currency reserve. The difference on the same was made good by the issue of a special creation of Government of India securities. These came to be known as *ad hoc securities* or *created securities.* They were to be written off from the interest derived from securities in paper currency reserve and gold standard reserve. During this war also they are being created but due to a different cause.

Babington Smith Committee Report. This report was submitted by a Currency Committee with Babington Smith as Chairman in December 1919. It recommended a 2 shilling gold ratio for the rupee. The Committee in its report pointed out the demerits of sterling exchange standard as opposed to gold exchange standard. It also removed war time restrictions. The report contained valuable recommendations regarding paper currency reserve and gold standard reserve. It was on the basis of this report first that percentage system of note-issue was accepted by the Government

of India. The recommendation regarding the ratio, however, could not remain in force for any considerable length of time.

Reverse Councils. These were the bills issued by the Government of India payable in London by the Secretary of State for India. They were first issued during the crisis of 1907-8 in order to meet the demand of the importers of foreign goods. Their issue was recommended by Chamberlain Commission to an unlimited extent in order to strengthen the rate of exchange.

Treasury Bills. These are the bills issued by the Government of India to the people in this country to obtain funds for meeting its day to day requirements. The period for which they have to run is three, six, nine or twelve months. Interest is paid on these bills by issuing them at a discount. The method adopted for their issue is that the tenders are invited from the public for a specified amount. These are opened on fixed days, and the lowest tenders aggregating to the amount required are accepted. The tendererers are then given the bills on the payment of the amount due.

II

SUPPLEMENTARY QUESTIONS

1. Why and how was the Gold Exchange standard established in India ? (*Delhi*)

Please consult answer to Q. 63.

2. Account for the violent fluctuations in the rupee-sterling exchange during the last Great War.

Please consult answer to Q. 54.

III

NET EXPORTS OR IMPORTS OF GOLD IN INDIA

(*In lakhs of rupees*)

NET IMPORTS

1900-01 to 1904-5	31,19
1905-06 to 1909-10	58,72
1910-14 to 1914-15	126,72
1915-16 to 1919-20	67,06
1920-21 to 1924-25	143,55
1925-26 to 1930-31	120,52
Total	547,76

NET EXPORTS

1931-32	57,97
1932-33	65,52
1933-34	57,05
1934-35	52,54
1935-36	37,36
1936-37	27,85
1937-38	16,33
1938-39	23,26
1939-40	44,64

Figures for subsequent years are not available.

RECOMMENDATIONS OF VARIOUS INDIAN CURRENCY COMMISSIONS AT A GLANCE

HERSCHELL COMMITTEE, (1893)

1. Closing of the mint to the free coinage of silver to the public.

2. Rupees to be issued in exchange for gold at 1*s*. 4*d*. or 7·53344 fine grains troy.

3. Gold to be received in payment of dues.

FOWLER COMMITTEE, (1898)

1. British Sovereign a legal tender and current coin in India. Mint to be opened in India for their coinage. Free inflow and outflow of gold. Gold currency standard.

2. Rupee coins to remain unlimited legal tender. Their coinage to be taken up only when gold coins were found to exceed the requirement of the public.

3. Profit on rupee coinage to be kept in gold as a special reserve.

4. Government to discharge its obligations in India in gold from this reserve so long as it is available.

5. Rate 1s. 4d. per rupee.

CHAMBERLAIN COMMISSION, (1913)

1. The gold exchange standard was suited to India.

2. The gold standard reserve should be strengthened :—

(a) No *limit.* Whole profit on rupee coinage to be credited to it.

(b) A much larger portion to be held in gold.

(c) The rupee branch to be abolished.

(d) Location in London.

3. Reverse Councils to be offered in India at 1*s.* 3 *29/32d.*

4. Elasticity of Paper Currency :—

(a) The fiduciary portion raised from Rs. 14 crores to Rs. 20 crs. Thereafter to be fixed at a maximum of the amount of notes held by Government in the Reserve Treasuries plus one-third of the net circulation.

(b) Loans to Presidency Banks out of the fiduciary portion.

(c) Rs. 500 Note universalized.

5 No gold currency for India.

6. A gold mint may be opened at Bombay, If not, to receive gold in exchange for rupees and notes.

BABINGTON SMITH COMMITTEE, (1920)

1. Gold Exchange Standard to be restored, not sterling Exchange Standard.

2. Rate 2*s.* gold.

3. The obligation of the Government to give rupees for sovereigns to be withdrawn.

4. Embargo on the export and import of *gold to be lifted.*

5. *Embargo on the import of silver to be* lifted but that *on the export of the same to be* continued.

6. The Gold Standard Reserve :—

(*a*) No limit.

(*b*) Considerable proportion in gold.

(c) Securities of governments within the British Empire but not those of the Government of India; maturity within a year.

(*d*) 50% of gold may be kept in India.

7. Council Bills and Reverse Councils to be sold without limit as and when required.

HILTON YOUNG COMMISSION, (1926)

1. Gold Bullion Standard. An obligation was imposed by law on currency authority to buy and sell gold bars at fixed rates, in quantities of not less than 400 oz. without any restriction as to the purpose.

2. The selling price of gold was, however, fixed at a different rate from that ofthe purchasing price in order to free the authorities in normal circumstances from the task of supplying gold.

3. Sovereigns were not to be legal tender.

4. Gold Savings Certificates redeemable in 3 or 4 years and yielding interest.

5. The coinage of the rupee to be stopped till its circulation was so reduced as to be available only for the purposes of small change.

6. New notes convertible into gold bars and *not into silver rupees were to be issued but the old notes were to continue convertible into* rupees.

7. Inconvertible notes of rupee one were to be re-introduced.

8. Unification of the gold standard and paper currency reserves and gold securities to form at least 40% of the total.

9. Establishment of the Reserve Bank of India with powers to perform all the central banking functions. All banks to deposit a fixed percentage of their demand and time liabilities.

CHAPTER VIII

INDIAN CURRENCY AND EXCHANGE

—(*continued*)

[RATIO PROBLEM]

Q. 68. What would be the effects on India's trade industries and agriculture if the exchange value of the rupee were reduced now from 1s. 6d. to 1s. 4d.? *(U. P. 1937)*

A. **Beneficial effects.** If the exchange value of the rupee were reduced now from 1*s*. 6*d*. the effects on India's trade, industries, and agriculture would be very beneficial.

Stimulus to exports.

Trade. First of all, a low rate of exchange acts as a stimulus to exports, as the same can be sold in foreign markets at low prices without at the same time lowering the proceeds available to the exporters. If the exchange value of the rupee were to be reduced from 1*s*. 6*d*. to 1*s*. 4*d*., prices of our exports would be automatically reduced by 1/11. But as there is no need for this huge reduction, a part of it may be used to increase profits. The country has, in recent years, also been building up a fairly good export trade in manufactured goods. Foreign competition on the same would, by lowering the rate, be eliminated to some extent. Besides, it would discourage imports as their prices would rise in the same proportion. It is, however, pointed out that this may not happen, if protective duties are levied by foreigners on our exports and bounties are given

Set-back to imports.

on imports. But this cannot be so, as most of our exports consist of food stuffs and raw materials which they must purchase. Moreover our manufactured goods are exported to countries having no manufacturing, and hence they would not like to place restrictions on them. As regards bounty on the goods we import, we need not fear. In case they do it we may levy import duties by way of retaliation. The net result of this, therefore, would be to increase our exports and decrease our imports. This would enable us to have a more favourable balance of trade. **Objections considered.**

Internal trade would also develop inasmuch as we shall have a greater purchasing power when we would gain as producers. **Development of internal trade.**

Industries. *We have already seen that it would give stimulus to our exports of manufactured goods and a setback to our imports of the same.* This would result in the development of our industries. More of goods will be required for foreign as well as our own markets. It is pointed out that the cost of machines which we import would increase. It may be so; but this will not retard the industrial development. These machines may also begin to be manufactured in this country. **Development of industries.**

Agriculture. Agriculturists will also be able to increase their exports and perhaps their profits too. It is, however, said that they being ignorant of the change would not be benefited by it. If any higher prices would be available they would be available to the middlemen. But this is not true in these days of competition. A part of the increased profits must go to the agriculturists in the long run.

Q. 69. Examine the arguments for and against fixing the value of rupee at 1s. 6d. Do you think that the time is ripe for going back to 1s. 4d. *(U. P. 1940).*

A. **Change would bring about a period of disturbance.** The main argument for fixing the value of rupee at 1s. 6*d*., as advanced by the Hilton Young Commission was, and for the continuance of the same, as advanced by the Government and its few supporters is that prices, wages, and contracts had or have all adjusted to it, and any change in the same would cause disturbance which must be avoided. The hollowness of the agrument is obvious. If there is a disturbance, it does not mean that it should not be welcomed even if it is beneficial. The main ground on which the question of the ratio should be decided must, therefore, be dependent upon the fact whether a particular rate is beneficial to a country as a whole or not.

The disturbance need not be feared if it is beneficial.

Other arguments for and against. We know that when after the War the currencies of the different countries were reorganised, their value was fixed either at or below the pre-War level. But unfortunately in the case of Indian Currency it was fixed above it. It has been said so often that U. K. had to face industrial and financial setback during the years between 1925 and 1931 only because it had restored the sterling to gold at the pre-War level, and as is known to every one of us, at the end it had to delink it as it could not bear the burden any longer. India is no exception. Her industrial and financial position has been hit to the most due to this over-valuation. It has given a great set-back to

Overvaluation after war.

Lesson from conditions in U. K.

our industries, and unemployment figures have consequently been swelling. Before September 1931, the maintenance of the ratio had been largely made possible only by contraction of currency, and since then our gold exports have helped the situation to a very great extent.

Maintenance possible only by contraction.

There is no doubt that since the sterling has gone off the gold, rupee has also been devalued in terms of gold and other currencies to the same extent as sterling has been. But the weightiest reason for the devaluation of the rupee, namely, undoing of the injustice done to the rupee by fixing it above the pre-War level after the War, still remains unremoved and must be removed.

Effects of fall of Sterling on rupee.

Remains over-valued

The devaluationists point out to the sanctity of the 16*d.* ratio. As against this the Government and its supporters say that 18*d.* ratio is as good as any other. It is of course true and more so today when it has been maintained for about 16 years. However, the 18*d.* ratio itself is no more sacrosanct than the 16*d.* one. In view of the need of rehabilitating prices, production and employment even a ratio of 16*d.* may not be enough.

No question of sanctity of any ratio.

It is said by those opposed to devaluation that devaluation of rupee may lead to competitive devaluation. This is really very strange. France has devalued her currency at least thrice without any effect abroad. What is India or the rupee in the scheme of world finance that others would mind it ? Even if they do so, where is the harm ? Let them devaluate. India has not checked them from doing what they

Fear of competitive devaluation

had liked in the past, nor would she do so in future.

Advantages. only temporary.

The up-holders of 18*d.* ratio say that the advantages of devaluation are bound to be only temporary. But that would be enough for India is the answer to this argument.

Fear of high tariffs wrong.

It is also said by some that devaluation may not help exports as the foreigners may impose *high tariffs against them. We know that the people abroad are not so foolish. Our exports* are largely in demand in manufacturing countries of the world and surely they will be only too happy to get their requirements cheaper. Even countries importing our manufactured goods will not do so as they have no industries to protect.

Question of time. Finally, as to the question whether the time is ripe for going back to 1s. 4*d.* only this much can be said that it can never be so if it is not today. In these days of disturbed currencies, manipulated exchanges, and unorthodox Governmental finances, to ask for international monetary stability is to ask for something impossible.

Q. 70. The Government of India do not consider it desirable to change the rate of exchange from 1s. 6d. to 1s. 4d. (Finance Member). Do you agree with this view ? If not, why not ? *(U. P. 1942)*

A. This question can be solved with the help of other questions on this topic.

Q. 71. Examine the arguments for and against the lowering of the rupee ratio to sixteen pence now. *(Rajputana)*

A. An answer to this question as well can be given with the help of the answers to the previous questions on this topic.

APPENDIX

SUPPLEMENTARY QUESTION

Q. 1. Examine the case of 18d. exchange *value of* the rupee as against 16d. exchange *value.* *(Delhi B. A., and Agra B. A.)*

A. Please consult answer to Qs. 68 and 69.

CHAPTER IX

INDIAN CURRENCY & EXCHANGE

—(*continued.*)

[PAPER CURRENCY SYSTEM]

Q. 72. Describe briefly the changes introduced in the Indian Paper Currency System with the establishment of the Reserve Bank of India, indicating the improvements effected by such changes. Is any reform still necessary in your opinion ? (*U. P. 1937*)

A. **Changes and effects** ; The change introduced in the Indian paper currency system with the establishment of the Reserve Bank of India and consequent improvements effected thereon are as follows : —

(1) **Bank-issue.** Note issue business has been transferred from the Government to the bank. The day it began to function it took over the management of the Currency Department of the Government by opening an Issue Department of its own. The Government has since then ceased* to issue notes, the liability of those already in circulation having been transferred to the bank. The bank issued its own notes first in 1938.

Government issue has ceased.

As a result of this change, the supply of currency is kept more in accordance with its demand than it could be kept previously. The

Bank in touch with the market.

*Since July 26, 1940, however, it has begun to issue 1 rupee notes also.

bank, being in intimate contact with the money market is in a position to know constantly more accurately and more quickly the day to day demand for it than the Government could. Besides, *the Government machinery being slow by nature, could not be expected to move in this direction rapidly even if it could know* the requirements so correctly and accurately. Moreover, the Government's policy of note-issue is guided by political considerations rather than by requirements. Bank's policy of note-issue, on the other hand, is not guided by any other motive. But so far as the Reserve Bank of India is under the control of the Government there is still a fear of this.

Government machinery is slow by nature.

Bank's policy of note issue solely guided by monetary considerations.

(2) Changes in Reserve. Formerly there were two reserves maintained by the Government of India, namely, (1) the gold standard reserve, and (2) the paper currency reserve. There was, however, in practice no demarcation between the functions of the two reserves, and hence their unification had been recommended by the Hilton Young Commission. It was brought about only with the establishment of the Reserve Bank. The entire stock of gold is now kept in the paper currency reserve.

Unification of p. c. r. and g. s. r.

There was made a change in the composition of the reserve also. The Government was under obligation to maintain a metallic reserve of at least 50% (gold and silver coins and bullion) and the rest could be kept in sterling and rupee securities. The bank, on the other hand, has to maintain at least 40% (with a proviso for temporary relaxation on certain conditions) of the reserve in gold coins, bullion, and sterling

Old composition.

Present compoition.

securities (maturing within 5 to 7 years). The other 3/5ths of the reserve are held in rupee coins, Government of India rupee-securities of any maturity, and eligible commercial papers payable in British India (with certain limitations on the amount of Government of India securities*). The amount of gold bullion and coins, cannot at any time be less than 40 crores of rupees in value. Of this at least 17/20 is always to be held in India.

Improvements due to these changes. The changes have brought about an improvement in the paper currency system in so far as it is more elastic now than it was previously. The Government of India could issue emergency currency on the recommendations of the Imperial Bank of India to the extent of 12 crores of rupees on the security of bills of exchange. The bank, on the other hand, can issue it now to a much greater extent. This has not only made it elastic but also automatic. When notes are issued on the security of bills money flows out of the bank, but when they get matured it comes back to it. The reserve of gold bullion, coins, and sterling securities can be reduced even below the minimum percentage on certain conditions, if there be any necessity. This could not be done under the previous system. It is a further provision for expansion in case it is required.

Greater elasticity.

Expansion and contraction automatic.

Further expansion possible.

Before the establishment of the Reserve Bank of India, a portion of the paper currency reserve was held in England for the purchase

*These limitations have been withdrawn as a war measure.

of silver. This discouraged the silver market of the country. With the establishment of the bank, no portion is kept in England for this purpose, and it is hoped that all the silver purchases will be made by the Government in India, whenever it shall have to do it. This will be beneficial to the silver market of the country.

Purchase of silver in Indian market

Reforms still necessary Paper currency is exchangeable into rupee coins or notes of small denominations. After all, rupee coins are also token coins. This means that one token currency is convertible into another. As a result of this, public has no confidence in the currency, and hence instead of investing its savings in banks and industries, it prefers to hoard it in the form of gold and silver bullion. This is a setback to industries and cause of resultant poverty and misery in the country.

One token currency convertible into another.

Confidence.

A portion of the assests is maintained in sterling securities, perhaps because the bank is under obligation to maintain the sterling exchange rate. This is not conducive to the interests of the country. In case the value of sterling falls, the amount of reserve also would be threatened. Besides, investing money in a foreign country, when there is already a field for an investment within the country itself, is not good. But this has to be done so long as the rupee is tied to the chariot wheel of sterling.

Sterling reserve

Investment within the country desirable.

Q. 73. Describe the existing system of paper currency in India, explaining the main items appearing in the weekly statement of the Issue Department of the Reserve Bank of India.
(U. P. 1938)

Items on the liabilities' side

Other informations regarding it.

A. **The existing system of paper currency in India.** The Reserve Bank of India has the sole monopoly* of issue of notes in this country. Total liabilities of the Issue Department of the bank consists of (1) Notes held in its Banking Department, and (2) Notes in circulation. The latter consist of those (*a*) legal tender in India, and (*b*) legal tender in Burma only. The denominations of the notes that it can issue is Rs. 5, 10, 50, 100, 500, 1,000, and 10,000. The bank, however, does not issue notes of Rs. 50 and 500 on account of their limited circulation. It undertook the liability of the currency notes in circulation of the Government of India issued before the taking up of this business by the bank. As against these notes, it has to maintain a reserve known as the paper currency reserve. This is represented by the assets in weekly statement of the Issue Department of the Bank.

Items on assets side.

Provisions for reduction.

Of the total assets, at least 40% must consist of gold coins, bullion and sterling securities. This minimum limit can, however, be reduced with the previous sanction of the Governor-General in Council for periods not exceeding 30 days in the first instance, which may with like sanction be extended from time to time by periods not exceeding 15 days. During such period of deficiency the bank is required to pay a tax on the amount by which it falls short, at the current bank rate with an addition of 1% per annum when such holding exceeds $32\frac{1}{2}$% of the total assets, and of a further $1\frac{1}{2}$% in respect of every further decrease of $2\frac{1}{2}$% or

*Since July 26, 1940, the Government of India also issues 1 rupee notes.

part of such decrease, provided that the tax is in no event payable at a rate less than 6% per annum. Of this reserve, at least 40 crores must be kept in gold bullion and coins, and of this at least 17/20 must be kept in India. We find this whole represented by total of A on the assets side. The details consist of gold coins and bullion and sterling securities. Of the former there are two divisions, (*a*) held in India, (*b*) held outside India. Generally we find total of A near about 60% of the total assets. Gold coin and Bullion is valued at 8·47312 grains a pound, and sterling securities at 1*s.* 6*d.* a pound.

Gold and bullion coins.

Of the remainder, represented by B Government of India rupee securities couldnot form more than Rs. 50 crores or ¼th of the total assets whichever be greater and with the previous sanction of the Governor-General-in-Council of such amounts plus a sum of 10 crores of rupees. At present due to the War, however, this limit has been given up. Then, we have rupee coins. These are issued by the Government of India. It is in these that the notes, are convertible.* They are supplied to the bank by the Government of India in quantities required by it. Then, there is an item of Bills of Exchange payable in British India, Its amount varies according as notes are issued on their being discounted by other banks or withdrawn when they get matured. This has made the notes issue elastic and automatic.

Rupee securities.

Rupee coins.

Bills of Exchange.

Q. 74. What do you understand by elasticity of currency? Briefly indicate to what

*Since July 26, 1940, they have been made convertible into rupee coins or rupee notes issued by the Government.

extent elasticity has been secured in the Indian Currency System in consequent of the establishment of the Reserve Bank. (U. P. 1939)

A. **Elasticity of currency.** In order to check wide fluctuations in prices, it is necessary to make the amount of the currency conform to the requirements of trade. This is possible † in the case of metallic currency as it is exported and imported according as is the trade condition of the country. But in the case of notes it is not so. No one can export or import them. Only the Government or the bank authorised to issue can issue or cancel them. Hence, if trade becomes brisk, nothing but a decree of the Government can supply the requisite increase of circulating medium and if more money is put into circulation and trade relapses into dullness, the currency becomes superfluous and falls in value. This power of notes to adjust their volume to the need for currency is called elasticity. Dunbar says, "Elasticity is responsiveness to present increase or domination of demand—the power of adaptation to the needs of the month, the week or the day, whether rising or falling."

Possibility in case of metallic currency.

Difficulty in case of note-currency.

Definition.

Elasticity in India. Elasticity has been secured in the Indian currency system to a greater extent in consequent of the establishment of the Reserve Bank. Prior to the same, the Imperial Bank was empowered to get from the Currency Department of the Government notes upto Rs. 12 crores in the busy season on the

Some elasticity even before the establishment of the Reserve Bank.

† This is not possible under metallic currency in all circumstances (1) Metal may not be available in the quantity required, (2) restrictions may be placed on its import and export.

security of inland Bills of Exchange. But this was not enough. Since the establishment of the bank, however, inland bills have been authorized to be kept in the paper currency reserve to a far greater extent. This has not only made our currency system elastic but also automatic. When notes are issued on the security of bills, money flows out of the bank, but when they get matured money comes to it. Elasticity has also been secured by making the percentage of gold bullion and coins and sterling securities reducible even below the percentage laid down. There is one more point. It is that bank issue has greater elasticity than the Government issue, as the former, being in intimate contact with the money market is in a position to know constantly more accurately and more quickly the day to day demand for money than the Government could. We also know that even if the Government could know the demand, its machinery being generally slow and subject to red tapism, it could not bring about the requisite change in the same.

Reduction of percentage.

Contact with market.

Government machinery always slow.

Q. 75. What was the system of note issue in India upto 1935? What changes were introduced by the Reserve Bank of India Act and why? *(1940)*

A. **System upto the year 1935.** Upto the year 1935, the note-issue bussiness in India was in the hands of the Government of the country It maintained a separate department, known as the Currency Department, for this purpose. From the year 1861, (when it took over the monopoly of note-issue from the hands of the Presidency Banks) up to the year 1920, when

Fixed Fiduciary Issue.

Paper Currency Amendment Act (1920), consequent upon the recommendations of the Babington Smith Committee was passed, the system followed by it was fiduciary system of note issue. In the beginning, *i. e.*, in the year 1861, the fiduciary limit was fixed at Rs. 4 crores. This was gradually raised by successive enactments to Rs. 120 crores by 1920. Paper Currency Amendment Act (1920) however provided for proportional reserve system. Though the percentage of the metallic reserve fixed by the Committee was at least 40, the Act laid it down at 50. The metallic reserve contained both gold bullion and coins, and silver rupees.

Proportional Reserve System.

System since 1935. The Reserve Bank of India Act provided for the transference of the note-issue business from the hands of the Government to those of the bank. Proportional system of issue was continued but with very important changes. According to the Act, gold coin, bullion and sterling securities must form at least 40% of the total paper currency reserve. In the 50% that the Government was required to keep, silver coins were also included. Here they have been excluded. Sterling securities now are to form a portion of this percentage. Since the passing of this Act the purpose of the paper currency reserve has not only been restricted to the conversion of notes into rupees but also to that of converting the currency into sterling. In fact even before it, the reserve performed both the functions, though in theory it was meant only for the conversion of notes into rupees, there being gold standard reserve for the conversion of the currency into sterling. Hilton Young Commission had shown how the functions of the two

Change in percentage and its contents.

Purpose of the reserve widened.

reserves were the same in practice and hence recommended their unification. It was brought about by this Act. The limit to the Government of India rupee securities is also fixed. Under the present Act, notes can be issued against the security of bills to a very great extent, while the Government of India could issue it only to the extent of Rs. 12 crores on the request of the Imperial Bank. This has not only made the currency elastic but automatic too, as when notes are issue on the security of Bills, money flows out of the bank, but when they get matured money comes to it. There is a provision for the reduction of 40% also under special circumstances with the result that we have now a greater elasticity than we could have without it. Bank issue has taken the place of Government issue with the same purpose in view.

Unification of g. s. r. and p. c. r.

Issue against Bills.

Greater Elasticity.

APPENDIX

SUPPLEMENTARY QUESTION

Q. 1. Point out the salient features of the Indian Paper Currency System as it exists at present. (*Delhi B. A.*)

A. This question can be answered with the help of Qs. 72 and 73.

CHAPTER X

INDIAN CURRENCY & EXCHANGE

—(*continued*)

[PRESENT POSITION]

Q. 76. Describe the existing currency standard in India. What are its defects and merits, if any; *(U. P. 1936)*

Existing currency standard in India. Since 1931, the country has been on Sterling Exchange Standard. There are two currencies, one for internal circulation and the other for external purposes. These are inter-convertible at fixed rates.

Sterling Exchange Standard.

Our internal currency consists of both metallic and paper money. Metallic money consists of the silver rupee and the eight-anna piece, four-anna and two-anna silver* and nickel pieces, one-anna nickel pieces, and bronze pice, half-pice, and pies. The rupee is 180 grains in weight and contains 90 grains of pure silver and 90 grains of alloy† It is a token coin, but is the principal medium of exchange and unlimited legal tender. It is, therefore, a standard token coin.

Internal currency.

Rupee.

Rupees and half-rupees are full legal tender. Other coins are legal tender upto Re. 1. All hese coins are minted by the Government of

Other subsidiary coins.

* Two-anna silver coin is not issued now.

† Rupees of 11/12th finaness are in the course of withdrawal.

India and supplied to the public through the Reserve Bank of India, according as it requires them.

Paper money consists of* Rs. 2; 5; 10; 100; 1,000; 10,000 notes, issued by the Reserve Bank of India. Notes of the value of Rs. 50 and Rs. 500 were also, sometimes back, under circulation. But they have not been issued by the Reserve Bank of India as they were not very popular. **Paper notes.**

There is a reserve maintained against the issue of these notes known as the Paper Currency Reserve. Its details are published in the weekly statement of the Issue Department of the Reserve Bank of India Balance Sheet. The law requires at least 40% of the total amount of notes issued to be kept in gold coins, gold bullion or sterling securities, provided that the amount of gold coins and gold bullion does not at any time fall below 40 crores of rupees. The gold coins and gold bullion are valued at 8·47 grains per rupee, and the sterling securities at 1*s.* 6*d.* per rupee. The rest is held in rupee coins and notes, Government of India rupee securities and bills of exchanges. Of the gold reserve not less than $\frac{17}{20}$ is to be held in India. **P. C. R.** **Composition.**

The Reserve Bank of India notes are convertible into rupee coins and notes. But this responsibility rests upon the bank only so long as the Government of the country supplies it with rupee coins. Notes of higher denominations are convertible into notes of smaller denominations. **Convertibility of notes.**

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* Since July, 1940, 1 rupee notes are being issued by the Government.

For external purposes we have got sterling. The Reserve Bank of India is under obligation to convert internal currency into sterling and sterling into internal currency at 1*s*. $5\frac{29}{32}$*d*. and 1*s*. $6\frac{1}{8}$*d*. respectively to the *rupee, in a sum of not less than £10,000.*

External currency.

Defects. The currency *system* as *it exists* at present is artificial and thus has failed to inspire confidence in the public. The experience of the past has shown that in times of crisis, large sums had to be given away to maintain the artificial value of the rupee. 1*s*. 6*d*. rate has also been subject to much criticism. Formerly, it was 1*s*. 4*d*. and Indians have been in favour of it since the change was introduced in 1927. Again, since September, 1931, sterling has not been convertible into gold. As a result rupee is also not convertible into it. Linking of the rupee with sterling which in itself has no fixed value has also been a subject of much criticism. The currency of the country has been unnecessarily tied to the chariot wheel of sterling, and thus moves in accordance with the movement of the dollar-sterling ratio—the fluctuations in which reflect changes in the English economic conditions rather than in the Indian economic conditions. Then, notes are convertible into rupee coins* which are themselves token coins. The result is that the people have no confidence in the currency and hence convert it into precious metals which go to their hoards. This is a great setback to the supply of capital to industries.

No confidence.

Large sacrifice.

Ratio question.

Sterling inconvertible and fluctuating.

Hoarding habit.

Merits. Notwithstanding all these defects

* Since July 1640, they are convertible into rupee coins and one rupee notes.

our currency system has a number of advantages. Firstly, it provides us with the most convenient form of currency for circulation. Secondly, issue of notes has been made over to a central bank which can expand or contract it according to *seasonal requirements. Fixed fiduciary system has been replaced by the proportional reserve* system under which elasticity has been secured. Finally, linking of rupee with sterling has also its own advantages. This has made our currency stable in terms of a currency in which we have most of our transactions.

Convenient.

Elasticity.

Stable in terms of sterling at least.

Q. 77. Mention and classify the various forms of legal tender money circulating in India.

How is the face value of rupee and that of the nickel coins maintained at a higher value than their respective intrinsic values (U. P. 1938.)

A. **Various forms of legal tender money.** The various forms of legal tender money circulating in India are (1) notes issued by the Reserve Bank of India, (2) metallic currency issued by the Government of India through the Reserve Bank of India, and (3) since July 26, 1940, one rupee notes issued by the Government of India as a war measure.

Metallic Currency may be classified into (1) unlimited legal tender, and (2) limited legal tender. Rupee and half-rupee coins are nnlimited legal tender, while all other coins are limited legal tender.

Metallic coins.

The face value of these coins is maintained at a higher level than their respective intrinsic values by keeping the mint for their coinage closed to the public.

Mint closed.

All other coins, except the rupee and half-rupee, are token coins. The value of such coins is maintained at a higher level than their respective intrinsic value in all the countries, by (1) keeping the mint closed to the public, and by (2) limiting their legal tender. Hence, there is nothing peculiar with regard to them in India.

Limited legal tender of subsidiary coins.

Rupee has, however, got no parallel. It is not a token coin. But at the same time it is neither a standard coin. It is an unlimited legal tender, and the principal coin of the country. Ordinarily, its value should have fluctuated with the value of silver. But it is not so. It is maintained at a higher level than what it ought to be, taking into consideration its metallic worth. This has been made possible only by restricting its supply. We know that the value of anything will rise in case its supply falls short of the demand. In fact, the supply of rupee is kept low. Besides, its value is maintained in the country at a higher level by law and outside the country by making it convertible with sterling at a fixed ratio.

Peculiar position of rupee.

Q. 78. Explain the system of Sterling Exchange Standard as it operates in India at the present time. Would you advocate any change in this system ? Why ? (*U. P. 1938*).

A. **Sterling Exchange Standard.** Under sterling exchange standard we have got (1) internal currency, consisting of notes issued by the Reserve Bank of India, and coins minted by the Government of the country, and (2) external currency, *viz.*, sterling. These are inter-convertible at fixed rates. The bank sells and purchases sterling for delivery in London in sums of not

Internal and external currencies inter-convertible.

less than £10,000 at 1*s.* $5\frac{49}{64}$*d.* and 1*s.* $6\frac{3}{16}$*d.* per rupee respectively. For this purpose, it maintains a stock of sterling in its paper currency reserve.

Purchase and sales of sterling through Banks.

Its operation. Ordinarily, when anybody *requires sterling for payment in London, he approaches one of the exchange banks, which issues a draft of its own payable at its head office or* branch there, in exchange for internal currency at rates varying according to the market conditions. Similarly, those who have to receive sterling in London sell it to these banks in exchange for internal currency. The banks in their turn sell or purchase the difference to or from the Reserve bank in sums of not less than £10,000.

Ratio question.

There has been a good deal of criticism on the rate of exchange maintained by the Reserve Bank. The pre-War level was 1*s.* 4*d.* But after the dislocation of the same during the War and post-War periods, when it reached 1*s.* 6*d.* sterling in 1924, the Government did not let it fall further. Since then upto 1931, it was kept at that level, whenever it tended to fall, by the contraction of currency which resulted in the fall in prices. Since 1931, the same has mostly been made possible due to the export of gold.*

Contraction of currency and gold export.

A setback to production.

Defects. Falling prices are detrimental to production, and have consequently brought about unemployment. High rate of exchange has also given stimulus to imports and thus reduced our favourable balance of trade. The position, however, seems to be quite satisfactory due to the export of gold. The proceeds of the same

Unfavourable balance of trade.

Gold export wasted.

*During war period, it has gathered strength because of our favourable balance of indebtedness.

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should have been ordinarily made available for the liquidation of foreign debt and further investment outside India. But this has been utilised in meeting up our day-to-day payments *due to the reduction* of India's ordinary favour*able balance* of trade.

Again, both of our export and import bills are drawn in terms of sterling. The result is that we have no bill market in this country. *Existence of a bill market is a necessity for the development of the banking system of a country. In fact, our export bills should be drawn in terms* of the internal currency.

Absence of a bill market.

Q. 79. What do you mean by the sterling requirement of the Government of India? On what factors do they depend, and to what extent is the rupee-sterling exchange affected by these sterling requirements? *(U. P. 1939)*

A. **Meaning of Sterling Requirements of the Government of India.** Sterling requirements of the Government of India mean the payments it has to make in London on various accounts. They consist of (1) the interest on loans contracted in England for the Indian Railways and Irrigation, (2) the purchase of silver bar for Indian Currency, (3) stores purchase, (4) pensions and furlough allowances, (5) expenses of the High Commissioner's office, etc. These in fact can be reduced very easily. First, of all loans contracted in London should be converted into loans contracted in this country. Now there is every surety of the funds being available here. Then the Government ought to purchase silver for currency purposes in India's Bullion Market. It would be beneficial

Diefferent kinds of payment.

They can be avoided with advantage.

to the bullion merchants of the country and at the same time will in no way be harmful to the Government. Again, stores of various descriptions should also be purchased within the country. They can be made available if only the Government shows its desire to purchase them here. This would bring about a rapid industrialisation of the country. Finally, public services should be Indianised.

Council Bills. Before 1923 these requirements were met by the Secretary of State by selling bills in London on India. These were known as the Council Bills. Their sale not only *enabled the Secretary of State to meet his obligations on behalf of the Government of India*, but also helped the foreign importers of Indian commodities to make remittance to their creditors here. In fact they played a very important part in the Indian Foreign Exchange, as they checked the rupee from rising above a certain level.

Purchase of sterling. Since 1923 the sale of Council Bills has however been stopped. The Government and now the Reserve Bank of India on its behalf purchases sterling in the open market. This is simpler and more convenient than the system followed previously. We know that the export bills originate in India and the liability of the Government of India to remit money also arises in the same country. It is, therefore, natural that the sellers and buyers of bills can best meet each other in the same country. Then, the factors which influence the immediate course of exchange can be judged more accurately and more promptly in the present method than they

Simpler and more convenient.

Regulation according to market conditions.

could be in the old method. Besides, the purchases can be regulated according to the varying conditions of the Indian exchange market and the remittance operation can be conducted so as *to avoid* violent fluctuations in rates and the consequent disturbance to the Money Market. Further, by this method the initiative in making *remittances and thereby fulfilling their liabilities is rightly given to the Government of India* which ought in principle, be able to remit smoothly and economically.

Rate of exchange controlled

In the system of Government remittance by Council Bills and their counterpart, the Reverse Councils, the Government found in the course of years the best method of controlling the rate of exchange. Now also the Reserve Bank by purchasing sterling on behalf of the Government helps the liquidation of much of India's favourable balance of trade and hence tends to check the sterling rate from rising.

Q. 80. Describe the nature and functions of the foreign exchange market in India indicating the various parties served by this market.

(U. P. 1936)

A. **Nature of the foreign exchange market.** Foreign exchange market is very peculiar in India. There are certain characteristics which at once distinguish it from that of any other important trading country in the world. The one predominant characteristic is the direct part which the Government of India plays in the currency and exchange system of the country.

Government plays direct part.

Since the closing of the Indian mints to the public for the free coinage of silver, the country has been on sterling exchange standard which

was gold exchange standard so long as sterling was in parity with gold. During and some years after the last Great European War, and since 1931, sterling was not or has not been in parity with gold, and hence during that period and at present, Indian currency system was not and is not based on gold in any way. Before the establishment *of the Reserve Bank of India, the whole responsibility of maintaining the standard lay upon the Government of India, and since then it has been* devolved upon it. All that is necessary under this standard is the power and ability of the authority responsible for its maintenance to sell and buy sterling for Indian currency at a fixed price. The Government of India had for this purpose a Gold standard Reserve and a Paper Currency Reserve, but the Reserve Bank of India has got only one of them. Most of the defects of the system should have been removed by the devolution of the responsibility to the Bank, but this has not been so, as the Government has a very tight control over it even now. And the worse is that the Government too is not free to act in the interests of the country. It has to look to the interests of the British Isles.

Reserve Bank not free to act

High rate.

The present price of our internal currency is 1*s*. 6*d*. There is a great *objection* against this ratio. Again, the danger of the rupee going out of circulation, if the price of silver rises above a certain point, always *remains.* Besides, the system does not secure the automatic expansion and contraction of currency. Such movements are too wholly dependent upon the will of the authority responsible for its maintenance. It has been often pointed out that this authority has expanded or contracted the currency in the

Melting point.

No automatic expansion and contraction.

past not with a view to obtain steadiness of prices, but with a view to obtain the steadiness *of exchange*. No doubt steadiness of exchange is also a thing to be desired for. But steadiness of exchange in the case of this country has *meant steadiness only in terms of sterling. And in times it fluctuates, Indian currency also* fluctuates. Dependency of one currency upan another is bad, and we have tasted the fruits of this dependency to a very great extent.

Remittance operation of the Government.

The greatest peculiarity of the Indian foreign exchange arises from the remittance operation of the Government of India. They have to remit annually nearly £35 millions from India to London through the Secretary of State to pay for Home Charges. The system of making remittance before 1923 was that of the issue of Council Bills. Since then it has been that of purchasing sterling in the country. The latter system is advantageous in several ways, the most important of these being that the purchases can be regulated according to the varying conditions of the Indian exchange market and the remittance operations can be conducted so as to avoid violent fluctuations in ratio, and the consequent disturbances of the Money Market.

Financing of foreign trade and remittance of Home charges.

Functions and parties served. This, therefore, is an additional function of Indian Exchange Market, besides the general function of financing foreign trade. The foreign trade of the country in its turn is not only the trade in merchandise but also the trade in precious metals. Before the year 1931, India imported these, but since then it has been exporting one of them—*viz*, gold. Then the imports of the

country also include a number of invisible imports. There are Europeans serving here. They make remittances to their dependents at home. Again, a huge amount of foreign capital is employed in the industries of the country. Its remuneration is to *be remitted out annually. Besides, India utilises a number of services of the foreigners—viz., shipping, insurance, brokerage etc., and it has to pay* for these.

Other remittances.

We have got exchange banks of foreign origin and these naturally look to the interests of the nationals of their respective countries. We have a number of grievances against them. The most important of them is that they have not established a discount market here. Both our export and import bills are drawn in sterling and are discounted in London. At least our export bills must be drawn in rupees. This will help the establishment of a bill market in India.

Exchange Banks and our grievances.

APPENDIX

SUPPLEMENTARY QUESTION

Q. 1. Point out the essential features of the Indian currency as it works at present.

(Calcutta 1940)

A. This question can be solved with the help of the answers to previous questions on this topic.

CHAPTER XI

INDIAN CURRENCY & EXCHANGE

(*Continued*)

[EFFECTS OF THE PRESENT WAR]

Q. 81. Discuss the effects of the present war on Indian Currency and exchange. (*U. P. 1943.*)

Restrictions on the purchase and sale of non-empire currencies.

A. **Effects of the present war on Indian exchange.** On the outbreak of the present war, restrictions were placed on the purchase and sale of non-Empire currencies. Dealings in them were allowed only for genuine trade purposes, travelling expenses and small personal remittances. Besides, all transactions were required to be done on the basis of the London Exchange Control combined with the current rupee rate. If there was made any attempt to do otherwise it was at once counteracted. For instance, when exports to U. S. A. began to be financed in sterling purchased at a discount in the free markets of that country, an agreement was made with American banks to quote it on the basis of the official London rates. Next, in order to put a stop to the loss of other exchanges as well consequent upon their power to purchase sterling at a discount, the Bank of England had to introduce a system of export control whereby export of certain commodities (and their number went on increasing) to certain countries (and their number also went on increasing) was not allowed unless the shipper produced evidence to the effect that he was receiving 'hard

Basis of rates fixed and all attempts to violate it counteracted.

The system of export control required the payments to be made in hard currencies which were to be offered to the Bank of England.

currency', i. e., the currency of some non-Empire country other than the one belonging to an enemy or occupied by him. Later on, shipment of such commodities was allowed only if a further assurance came that the currency so received would be handed over to the Bank of England. It is needless to say that the measures introduced by the Bank of England were also introduced by the Reserve Bank of India as well, and the currencies acquired by the latter were handed over to the former. The handing over of such currencies to the Bank of England, it may be pointed out, was deemed necessary with a view to conserve the proceeds of the sales of Empire countries for the successful prosecution of the war. An interesting result of the above regulations was a large increase in the volume of exports financed by bills in foreign currencies and a fall in those financed under London sterling credits. This was accentuated by the suspension of air mails to London after the collapse of France.

Conservation of proceeds for the successful prosecution of war

Exports financed by foreign bills instead of by sterling bills.

As the war developed and strain on U. S. dollar resources of the Empire became heavier, further measures were taken to conserve foreign exchanges. These included a system of import control, increased restrictions on remittances for other than trade purposes, and acquisition of U. S. dollar holdings and securities and Bank of England notes of all residents in British India by the Government of the country. But this also could not help much, and in the end lend lease procedure had to come to rescue.

Other measures to conserve foreign exchanges.

With the extension of war to the Near East, the Japanese Government imposed restrictions on the drawing of bills in sterling or on places west of

Development of an entrepot trade.

Bombay against exports from Japan. The result of .this was that *importers in the Middle East were forced to make their purchases of Japanese goods through Bombay. A large entrepot trade* in Japanese goods thus developed in this country and measures had to be taken to ensure that India was not called upon to provide foreign exchanges for which she received no corresponding return

Freezing of Japanese balances.

In July, 1941, orders were issued freezing the balances of all Japanese companies and firms resident in India. On the out-break of hostilities with Japan, the assets of Japanese companies and firms in India including those of Japanese banks became vested in the custodian of the enemy property.

Rupee-sterling market featureless.

Besides, several other steps have been taken with the main object in view. In the end, it may also be said that the rupee-sterling exchange market has remained during this war unlike during the last war featureless.

Effects on Indian currency. The effects of the present war on Indian currency have been varied.

Rush for encashment of notes.

(1) There was a rush for encashment of notes. Prior to June, 1940, this was, of course, not great. But with the collapse of France, in the month mentioned above, it increased, and in consequence thereof, the Government had to take steps to counteract it. A sort of rationing system was introduced in many places. Besides, one rupee notes were introduced, and these began to be exchanged for notes of higher denominations.

Absorption of currency.

(2) There has arisen a tendency for the absorption of currency on an unprecedented scale. Circulation of notes and coins of all denomina-

tions has tremendously increased during this *period.*

Craze for hoarding rupee coins.

(3) There developed in the public a craze for hoarding rupee coins. For sometime, however, the Government tried to meet it. But soon, it was felt that some action was necessary to deal with a situation under which the mints working at full pressure could not replace the coins disappearing from circulation, and which involved a great inconvenience to the public and danger to the community. Hence, by a rule promulgated under the Defence of India Act, acquisition of coins by a person in excess of his personal or business requirement has been declared to be an offence.

Government of India one rupee note.

(4) Scarcity of a unit of exchange smaller than the lowest denomination of notes was acutely felt as a result of the hoarding of rupees. Government accordingly issued an Ordinance providing for the issue and putting into circulation of Government of India one rupee notes.

Two-rupee note.

(5) Reserve Bank of India issued two rupee notes as well with a view to reduce the demand for rupee notes and coins which had been rising very rapidly.

Reduction in the fineness of silver coins.

(6) The Indian Coinage (Amendment) Ordinance reduced the fineness of the half-rupee, and the Indian Coinage (Third Amendment) Ordinance that of the whole rupee from $\frac{11}{12}$th of fine silver to one-half of fine silver. In view of the increasing simultaneous demand for half-rupees and whole rupees, it was felt that it would be wasteful to turn out large quantities of these coins of the old fineness. It was also felt that this reduction of fineness would discourage their hoarding as

well. The new rupee coin is milled on the edge with a serrated or upright milling ; in the centre of the milled edge, there is a shallow groove with a design inside two sections separated by blank spaces, and the design inside the groove consists of alternate heads and diagonal lines in *relief.*

Withdrawal of standard coins.

(7) Victoria and Edward VII standard rupee and half rupee coins ceased to be legal tender with effect from the 1st May, 1943, and George V and VI standard rupee and half rupee coins from the 1st November, 1943.

Introduction of a new half-anna coin, and use of nickel-brass alloy.

(8) With a view to meet the demand arising out of war-time activities, a new half-anna coin economising the metal and convenient to the public was issued in January, 1942. Further, with a view to economising the use of nickel, it was decided to mint the new half-anna piece and the one anna coin and later on the two-anna coin in a nickel-brass alloy instead of the cupro-nickel alloy.

Shortage of small coins.

(9) With the feeling of acute shortage in small coins in general and one pice bits in particular, their hoarding has been declared to be illegal. Besides, the standard weight of the two anna, one anna, half anna and quarter anna has also been notified to be reduced to 90, 60, 45 and 30 grains troy respectively.

Changes in the paper currency reserve.

(10) With an increase in note-circulation a corresponding increase has been brought about in the paper currency reserve as well. (*a*) Rupee coins include now one rupee notes also ; (*b*) the limit to the holding of rupee securities originally prescribed in the Reserve Bank Act has been withdrawn and (*c*) gold holdings in London have

been cancelled by a transference of the gold holdings of the Bank of England with the Reserve Bank for India to the paper currency reserve; (*d*) the percentage of the holdings of sterling securities in the paper currency reserve has been going up despite their transfers in connection with the *repatriation of sterling debt mainly because of India's favourable balance of trade and purchases made and expenses incurred by the Government* of India on behalf of the allies.

Inflationary tendencies.

(11) Finally, inflationary tendencies have steadily gathered strength, encouraging and being in turn encouraged by scarcities of essential commodities including food-stuffs and cloth.

APPENDIX

SUPPLEMENTARY QUESTION

Q. 1. Discuss the effects of the present war on Indian currency system.

(*Allahabad 1943*)

A. An answer to this question can be given with the help of the answer Q. 81.

CHAPTER XII

MISCELLANEOUS

Q. 82 Describe the respective functions of currency notes and bank deposits as circulating media of exchange in a modern community.

(U. P. 1936)

Notes and cheques more advantageous than coins.

A. **Currency notes and bank deposits both perform the function of circulating media.** Currency notes and bank deposits both perform the same functions as circulating media of exchange in a modern community as coins made of metal do. In fact, these are in the world of today far more important than coins; for they are habitually used to make larger payments and have far more influence on monetary conditions. There are great differences between country and country in the use made of currency notes and bank deposits as circulating media of exchange. Some countries issue currency notes for very small amounts, while others have notes only of denominations considerably larger than their current metal coins. In some countries quite big transactions are habitually settled in currency notes, whereas, in others cheques, which arise out of bank deposits, are generally used in transactions involving considerable amounts. Let us see the nature of these two kinds of circulating media of exchange.

Their respective popularity differs from country to country.

Currency notes. These are, in form, merely promises to pay. The authority issuing them

Their nature

promises to pay the holder of the note so much in current national money. This may be made of gold or silver. Sometimes there is a promise *to pay in bullion. But where the gold standard* or some alternative metal standard does not exist the promise to pay engraved on the face of the currency note becomes a fiction. For these are met only by paying out other notes or merely token coins (case in India is an instance) or by crediting the holder with a deposit in books (this is possible in case of only bank notes). And this deposit will confer no right except that of reconverting it into notes or token coins or transfering it as a deposit to some one else. But whatever it may be, these perform the functions of money quite all right.

Bank deposits. In developed communities more and more transactions come to be settled not by paying over notes or coins but by cheques. A cheque is essentially an instruction to a banker to pay over to some person a sum of money standing to his credit at the bank. If the person to whom the cheque is paid out chooses to receive payment in notes or coins, he is at liberty to do this. But far more often the recipient of the cheque simply pays it into his own banking account, and the transaction involves directly no payment in notes or coins at all, but only a transfer of bank credit from one person's account to another's either in the same or in a different bank. So these too resemble notes in this respect.

Nature of cheque.

Points of difference. But there are points of difference too between them. A note is a promise to pay, and it passes easily from hand

Notes circulate for a longer period than cheques.

to hand in a whole succession of transactions, without necessarily being ever converted into any other kind of money, even if it is in fact convertible on demand into coin or bullion. But a cheque, though it may occasionally pass through several hands and so be used as money, commonly fulfills its purpose in the course of a single transaction and is thereupon cancelled when its work is done. It does not normally circulate from hand to hand as coins and notes do, for it is a promise to pay not by an authority of considerable repute, *e.g.*, Government of the country or central bank, but by the individual whose signature appears upon it, and its value depends on the condition of that individual's account at the bank. Most cheques are made out to 'order' and not to 'bearer', and order cheques require endorsement by the person in whose favour they are made out. Many cheques are crossed which means that they cannot be directly cashed but only paid into an existing bank account. In the light of these facts it is surely plain that cheques do not perform the same functions as circulating media as notes. But what about bank deposits upon which a cheque is based?

Cheque, promise of individual.

Order cheques.

Crossed cheques.

Bank deposits. These can be classified in either of two ways, and each classification divides them into two groups. The first is that which draws distinction between 'current' and 'deposit' accounts. The banks can lend on the strength of deposit accounts because money cannot be withdrawn out of this account before the fixed time has passed. But they can also create credit on the basis of the current doposits as they know that a considerable aggregate amount

Current and fixed deposits.

Credit given on the basis of both.

will at any time be found lying unused with them. It is only in times of business crisis that the sense of security is undermined and depositors withdraw their money. But this is also the case with notes. There are times when they too are cashed and money is withdrawn. Normally an individual's current account in the bank is in effect a substitute for the notes and coins he would otherwise have to keep in his possession for settling current business transactions. The amounts of money which the customers of the banks are disposed to keep in deposit either in their current or in their deposit accounts are influenced by the condition of the business. The money kept in deposit account is, however, more influenced by the same. The other way in which bank deposits may be classified is to distinguish the deposits made of money deposited by customers, from the deposits made of money lent by the bank. When a bank grants a loan or overdraft, the effect is to create an additional supply of purchasing power upon which the recipient of the advance can draw in the same manner as he draws when he actually deposits money. 90% of the deposits in advanced countries are deposits of this type.

Both realised during crisis.

Current account a substitute for notes and coins.

Cash deposits and loan deposits.

Conclusion. We then come to this conclusion that bank deposits perform the same functions as circulating media as currency notes do. Day-to-day transactions can be settled through both of them. If business is brisk both the notes and deposits are used to a very great extent. On the other hand, if it is slack both lie unused. It may be that under such circumstances people might transfer a considerable part of their money from current to deposit account.

Bank deposits perform same functions a notes.

Volume of both dependent upon the credit policy of the central bank.

Just as notes can be inflated and deflated, bank deposits can also be done so by the bank's credit policy. Notes are issued against bills, and deposits are increased by granting advances based on securities of various kinds. In case, it is desired to deflate notes, rate of discount is raised. This decreases note issue and as well as bank deposit. People do not like to pay a very high rate of discount on bills nor do they like to pay high rate of interest on advances which make up deposits.

Q. 83. X wants to send a remittance of £ 500 to London. What methods are open to him to remit the above amount? Advise him.

(U. P. 1939)

A. **Purchasing a Bank Draft.** The most popular method is to purchase a bank draft from any bank doing this business. There are exchange banks and joint stock banks with correspondents abroad who will readily agree to any such proposal. They, first of all, quote the current rate of exchange. On deposit of the equivalent amount of Indian currency along with the necessary charges by way of commission, a draft for the required sum would be issued. This shall have to be sent to the payee by *X*, the remitter. On receipt of the same in London, the proceeds will be realised.

Sending the same by T. T. A bank draft will take some time to reach its destination. If, however, money is immediately required to be received in London, a T. T. may be purchased. In this case, the remitter will deposit Indian currency at the current T. T. rate with some exchange bank. Charges for T. T. are a bit

higher than the charges for issuing bank draft. They include the telegraphic charges as well as the money is sent here by means of a cable.

Purchasing an Export Bill. For goods exported to merchants in London, bills are drawn upon them or their bankers. If a bill of an equivalent amount is available, it may be purchased. The method is, however, not popular. Firstly, a bill of the required amount may not be available. Secondly, there will be difficulty in finding out a merchant wishing to sell the bill. Thirdly, payment of the bill in London depends upon the safe delivery of shipping documents. As such the method is dangerous.

APPENDIX

SUPPLEMENTARY QUESTION

Q. 1. If you wish to remit £ 5,000 to your business friend in London what are the alternative methods open to you to send the money? Which method would you prefer and why?
(*U. P. 1941*)

A. An answer to this question can be given with the help of the answer to *Q.* 83.

PRINCIPLES OF BANKING

CHAPTER XIII

CREDIT

[ITS NATURE AND FORMS—ADVANTAGES AND EVILS—CREDIT INSTRUMENTS—BILLS OF EXCHANGE AND PROMISSORY NOTES—HUNDIS——CHEQUES—ITS DEFINITION AND KINDS—HONOUR AND DISHONOUR—CROSSINGS—SPECIMEN—PROCEDURE FOR ENCASHMENT—CAMPARISON OF VARIOUS INSTRUMENTS OF CREDIT.]

Q. 84. What is credit ? Describe its nature and forms. Mention its advantages and evils. (*Rajputana*)

Meaning

Definition.

Essentials.

A. **What is credit ?** Credit in its literal sense means trust or confidence. Actually, it means postponement of payment. It may be defined as an exhange which is not complete until a certain period of time has expired. In fact credit involves three essentials, ***viz.***, (1) exchange or transfer of value, (2) time, and (3) confidence both in the integrity and capacity of the borrower.

Fallacy.

Its nature. Since the industrial revolution credit has been assuming such importance that some people are inclined to believe that it is real wealth, true capital, and a factor of production. In order to decide whether this is so, we must find out if credit alone, without the help of anything else, is capable of satisfying human wants as this is the chief characteristic of wealth.

And if the answer is in affirmative, we must further find out if it can be used for production, as wealth used for production is capital. It is on the basis of these findings that we shall be able to decide finally whether it is a factor of production. First of all, credit is not wealth in itself. Howsoever confidence we may have in some one, his confidence alone will not enable him to raise capital, if none has got some wealth to give him. But sometimes credit is granted by bankers far in excess of money they possess. Roughly, it has been estimated that if a banker possesses Rs. 10, he can grant a loan of Rs. 100. In so far as this happens there are people who say that credit is certainly wealth. But the fact is that this multiplied wealth has for its basis some real wealth without which it could not have come into existence. We can, then, say that credit multiplies wealth and when it is used for production it gives it the form of capital. In short, credit makes wealth more useful. It is not, therefore, a factor of production, but a method of production. It makes capital more efficient in the same way as division of labour makes labour more efficient.

Credit is no Capital. It rather makes it more efficient.

Forms. Credit has various forms, *e.g.*, commercial credit, bank Credit, public credit, industrial or capital credit, individual or personal credit. When merchants buy commodities with their credit, it is known as commercial credit. But this credit is very limited in scope and soon terminates. In order to extend its area and time, it must be exchanged with bank credit. Bills of exchange form commercial credit. Their circulation is limited. But as soon as they are exchanged with bank credit, notes, they can be

Commercial credit.

Bank credit.

circulated over a much wider area. There are only some persons who know a particular merchant, and he cannot buy goods on credit from others with his own credit. He can, however, exchange his credit with that of the bank. The bank allows him to draw cheques, which are accepted by everybody. This is another form of bank credit. Public credit means the borrowing operations of government by means of interest-bearing securities. Capital or industrial credit refers to the borrowing of finance by industrial concerns. Individual or personal credit refers to the obtaining of individuals of goods for consumption on credit. These credits may be obtained either by means of credit instruments or by means of book entries. In the latter case, it is known as book credit.

Public credit.

Capital credit.

Individual credit.

Book credit.

Advantages. Credit gives rise to credit instruments which serve the purpose of metallic currency. They (*a*) constitute a cheaper medium of exchange than metallic currency, (*b*) are more convenient to handle, and (*c*) fill up the shortage of metallic currency which alone cannot fully meet the requirements. These instruments also make transmission of money to distant places cheap. Settlement of foreign payment is much facilitated through them. It makes possible also the collection of unspent parts of the incomes of the people, and habit of thrift is thus inculcated in the masses. This collection, in its turn, is placed at the disposal of those who are best fitted to use it for further production of wealth. The vast production that has been going on all round us has been made possible only by credit. It also minimises price fluctuations. Banks, known as coiners of credit, coin it whenever there is a need

Credit instruments serve the purpose of metallic money.

Inculcates habit of thrift.

Stimulus to production.

Steady prices.

for more currency, and destroy it as they find that it is redundant. Governments are enabled by means of credit to tide over financial stringencies. Finally, it helps individuals in times of hardship when they are temporarily short of funds to remove their difficulties.

Advantageous to governments.

Evils. Credit which is the source of so many benefits and advantages is also attended by some dangers. The liability of its being overissued is its greatest evil. When such is the case, it leads to excessive zeal, overproduction and speculation. It also enables a man of doubtful ability to start a speculative and unprofitable business, and thus not only to ruin himself but others also. Consumers in a position to obtain credit, obtain it only to become financial wrecks. Finally, it has also given rise to capitalism with its resultant evils, *e.g.*, competition and exploitation of labourers.

Overissue.

Incapable men helped to continue and ruin.

Reckless expenditure.

Capitalism; its evils.

Q. 85. Explain the nature and uses of (a) trade bills, (b) finance bills, and (c) bank bills. *(U. P. 1940)*

A. **Nature and uses of (*a*) trade bills.** Trade bills arise out of trade transactions. In case a merchant buys goods on credit from another, there are two courses open for the settlement of the transaction. Firstly, either an entry, is passed in the books, or secondly, a bill of exchange is drawn by the seller upon the purchaser. The first form of credit is known as *Book Credit* while the second is known as commercial credit. This bill has to run the period for which credit has been granted. This form of credit is advantageous over the former in several ways. Firstly, it assures settlement on maturity. The merchant

Arise out of trade (credit) transactions.

Payment assured.

accepting it cannot deny the payment. In the event of default, the transaction which gave rise *to the bill is not considered as is the case when a book credit is given, but the bill itself is regarded* to be a prima-facie evidence of the existence of *the debt. Moreover, payment of bills on maturity* is a question of reputation. A book debt may not be paid on the lapse of the, period of credit but a bill of exchange must be paid to maintain reputation in the market, on its maturity. The drawer of the bill instead of holding it till maturity may transfer it to somebody else in payment of his debt or get it discounted in the bill market and receive money for replenishing the stock. Besides, a trade bill provides a good form of investment for bankers. In foreign countries, it is very popular with them. Finally, a bill of exchange is also used for remittance of money from one part of the country to another or from one country to another.

Provides a means of remittance.

Drawn in anticipation of the produce.

(*b*) **Finance bills.** Finance bills are bills created not on the basis of the goods sold but on the basis of the goods likely to be produced or manufactured. They are also known as anticipatory bills. In Western countries such bills are drawn in order to finance agricultural industry. In our own country, their use was recommended by the Banking Enquiry Committee. Their payment is made on the sale of the produce in order to help whose production they are drawn. Farmers need money for carrying on their day-to-day operations, which they can pay only on the production and sale of the crop. There is no danger if on the basis of this, they are provided with funds through finance bills. So far as they are drawn for this purpose they are quite legitimate

Highly useful and quite legitimate but not if drawn merely for discounting.

and higlhy useful. But the creation of such bills has been carried further, and they are created for the mere purpose of discounting them. Bills thus created are difficult of realisation.

(c) ***Bank bills.*** *These are the bills drawn by* one banker upon another or drawn by a customer upon his banker. In the former case, they are called bank drafts, and in the latter case, they are known as bank acceptances. The former is drawn in case a customer of the bank deposits with it some money for remittance to some other place within the country or outside it. Besides providing a good means of remittance, they also provide deposits for the banks, which they can utilise at least so long as they are not withdrawn by the payee. Bank acceptances are very useful. They provide the customers with the money without bank being called to make the payment. Before maturity, it is paid back by the customer to enable the bank to honour its signature. Herein, bank exchanges its credit for that of its customers. Bank credit, we know, has a much wider circulation than the credit of the merchants.

Bank drafts or acceptances.

Good means of remittance and a good source of deposit.

Through Bank acceptances individual credit is exchanged with Bank credit.

Q. 86. Trace the course of a bill of exchange from the time it is drawn till it is presented for payment.

Discuss in this connection the respective rights and liabilities of various parties to a bill of exchange. *(U. P. 1937)*

A. **Course of a bill of exchange.** In case, a bill of exchange is drawn by somebody in his own favour, it must be got accepted by the drawee as soon as possible. If it is, however, drawn in favour of somebody else, he should get

Sent for acceptance either by the drawer himself or by the payee.

Three courses open to holder: – (i) Retain it till maturity. (ii) Transfer. (iii) Discounting.

it accepted on the first convenient opportunity available to him for doing so. The drawee of a bill is expected to return it accepted within a reasonable time. The holder has three courses of dealing with it. Firstly, he may retain its possession till maturity. Secondly, he may transfer it to his creditor in payment of debt. And thirdly, he may get it discounted in the money market. Bills are discounted in the money market with bill brokers, discount houses, and banks. Bill brokers were originally mere intermediaries between banks and holders of bills, and conducted this business for a small amount of brokerage. Now, many of them purchase these bills in order to pass them on to banks later on. In this way, they are enabled to earn a larger income. They hold these bills temporarily and that too mostly out of the funds borrowed on short terms from banks. They are very useful as being in constant contact with the market, they better know the position of the drawers, acceptors and endorsers of the bills. They also know the proportion of the bills of each firm that are current on the market. They are, therefore, always in a position to judge the merits of a bill as soon as it is brought to them. Discount houses, on the other hand, are permanent holders of the bills discounted. They rediscount their holdings only when they find a huge demand for money. They depend to a lesser extent upon advances from banks. Bills provide a good form of investment for banks as they are self-liquidatory and continuous. These can also be rediscounted by them with the central bank, which is empowered to provide currency on their basis.

Business of bill brokers.

Business of Discount Houses.

Advantages to banks.

Respective rights and liabilities of vari-

ous parties. Every holder of a bill of exchange who has taken a bill, complete and regular, on the face of it, provided he has fulfilled certain conditions, has a right to get the payment of the bill first of all, from the drawee, and in case of failure, from any of the previous holders including the drawer. The conditions necessary are that he must have become its holder before it had become over-due and without notice that it had been previously dishonoured, if such was the case. Further, that he must have taken the bill in good faith and for value and that, before the bill was negotiated to him, he had no knowledge as to any defect in the title of the person who negotiated it. If the bill is paid by the drawer or any endorser, such a drawer or endorser has got the right to claim the money from the drawee. If a bill is lost, the holder in due course has the right to get its duplicate. In case of dishonour, the holder can also claim the compensation as given in the Negotiable Instrument Act. The right of the drawee is that the bill of exchange of which the payment is due must be presented to him during the usual business hours.

Rights of a holder.

Drawer's and endorser's rights against the drawee.

Issue of a duplicate bill.

Claim for compensation.

As regards liabilities to a bill, we have to consider (1) the *acceptor*. This is the party which is primarily liable to pay a bill. By accepting it, the acceptor undertakes to pay it, and if he dishonours it by refusing to pay at maturity, he may be sued upon it by the drawer or any endorser or holder in due course. Absence of consideration is no defence. (2) *The drawer.* Until the bill is accepted, the drawer is the main party, and hence he is primarily liable to the endorsees. But as soon as it is accepted by the drawee, he is relieved of his primary liability.

Acceptor is primarily responsible for its payment.

Nature of Drawer's liability.

From that time his liability becomes contingent. And (3) *the endorser*. His liability is more limited than that of either the acceptor or drawer. An endorser is liable only to subsequent endorsers, and not to the previous endorsers. On the other hand, he can hold them liable, in case he is called upon to make the payment. The last endorsee is required to present it on the due date. If he fails to do this, the drawer and all the previous endorsers are freed of their liability.

Nature of Endorser's liability.

Last holder's responsibility

Q. 87. Summarize the laws in India regarding bills of exchange. (Rajputana 1941)

A. **Laws in India regarding bills of exchange.** The laws in India regarding bills of exchange are found codified in Bills of Exchange Act. First of all, there is its definition, according to which, it is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument. Next is its classification. It is of two kinds inland and foreign. An inland bill of exchange is drawn or made in one country and made payable in or drawn upon any person resident in the same country. A foreign bill of exchange, on the other hand, is not so drawn, made or made payable. Further, it has been laid down that in case the drawee of a bill is the same as the drawer or is a fictitious party, or is a party not having capacity to contract, it may be treated by the holder as a promissory note. There is also the question of the date of maturity. Bills are payable either on demand or sight or so many days after sight. If payable so many days after

Definition.

Classification.

Treatment of a bill as a P/N.

Date of Maturity.

date or sight, the bill must bear advalorem stamp. Three days, called days of grace are, in every case, where the bill itself does not otherwise provide, added to the time of payment as fixed by the bill, and it is due and payable on the last day of grace. In case, however, the last day of grace is a holiday, it is due and payable either a day before or a day succeeding depending upon the fact whether it is a bank holiday or a public holiday. There is also provision for their negotiation. Regarding the sum a payable by a bill, it has been provided that it is a certain sum in money although it may be required to be paid with interest or by stated instalments, etc., or according to an indicated rate of exchange.

Advalorem stamp.

Days of grace.

Provision for negotiation.

Amount of the bill.

Coming to acceptance, first of all, there is *the definition and its requisites. Then, there is* a time allowed for it. Further, there are general and qualified acceptances. A general acceptance assents without qualification to the order of the drawee. A qualified acceptance, on the other hand, varies in express terms the effects of the bill as drawn. It depends upon the will of the holder whether he regards a qualified acceptance as an acceptance or as a dishonour of the bill. The capacity to incur liability as a party to a bill is co-extensive with capacity to contract. Regarding forged or unauthorised signature, it may be said that where a signature on a bill is forged or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorised signature is wholly inoperative unless the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority.

Acceptance.

Capacity to incur liability.

Forged signature.

Consider-ation.

Accommo-dation bills allowed.

Then, there is a provision regarding the consideration for a bill. It may also be an accommodation bill. An accommodation party is liable on the bill to a holder for value, and it is immaterial whether when such holder took the bill, he knew such party to be an accommodation party or not. The holder of a bill must present it to the drawee for acceptance and payment. There are rules as to presentment for acceptance and payment and excuses for non-presentment. When a bill has been dishonoured by non-acceptance or by non-payment, notice of dishonour must be given to the drawer and each endorser in accordance with certain rules. Where an inland bill has been dishonoured it may, if the holder thinks fit, be noted for non-acceptance or non-payment, as the case may be, but it is not necessary to note or protest any such bill in order to preserve the recourse against the drawer or endorser. The measure of damages ascertained in a given way can also be claimed from the drawee in case of dishonour of a bill.

Present-ment of a bill.

Notice of dishonour.

Noting and protesting

Claim for damages.

A bill is discharged by payment in due course, which means payment made at or after the maturity of the bill to the holder thereof in good faith and without notice that his title to the bill is defective. It is discharged in several other ways. A bill may also be accepted and paid for honour. Where a bill has been lost before it is overdue, the person who was its holder may apply to the drawer to issue a duplicate thereof.

Discharge of a bill.

Q. 88. Give a short description of the different kinds of Hundis which are generally in use, indicating their special features. Draw a specimen Hundi by way of illustration.

(*U. P. 1937*)

Names.

A. **Different kinds of Hundis.** Hundis are *mainly classified into (a) Muddati (Time)* Hundis and (*b*) Darshani (Sight or Demand) Hundis. These are, however, further sub-divided into; (1) Dhanijog (Payee only), (2) Shahjog (resembling to some extent with crossed cheques —bills of exchange are never crossed), (3) Dekhanhar (bearer), (4) Farmanjog (order) and, (5) Jokhami (there is no equivalent of it in modern bills—it forms, in short, a combination of a bill of exchange, an insurance policy, and a contract of afreightment in one.)

HUNDIS

Darshani Muddati

Dhanijog Shahjog Farmanjog Dekhanhar

Dhanijog Shahjog Farmanjog Dekhanhar Jokhami

Muddati Hundi.

Their special features. Muddati Hundis are Hundis payable after they have run their period of tenor. This period of tenor varies from place to place and trade to trade ranging generally between 11 days to 12 months. To the period of tenor, days of grace known in Hindi by the term (*gilas*) are also to be added in order to find out the date of maturity. Darshani Hundis, on the other hand (akin to sight or demand bills), are payable on presentation. They are mostly drawn with a view to facilitate remittance of money.

Darshani Hundi.

Sub-division. Then, Hundis may be Dhanijog, Shahjog, Farmanjog, Dekhanhar, and Jokhami.

Dhanijog. Dhanijog is a Hundi payable only to the payee. It cannot be endorsed. The liability of the drawee is very great here. He has to satisfy that the party presenting the Hundi is none else but the payee mentioned within the body of the Hundi. In case he makes a wrong payment, he is held liable to the real ***dhani*** (owner-payee).

Shahjog. Shahjog Hundi is payable only to a *Shah*—a respectable merchant of the town where the drawee resides. A holder of such a kind of Hundi cannot get its payment himself if he is not a *Shah*. He must present it through him. In case, the drawee violates the condition, he is held liable to the holder in due course for his loss.

Farmanjog. Farmanjog Hundi came in vogue during the Mohammadan period. It is payable to the payee or his order. It cannot be transferred without endorsement known in Hindi (*Bechan*). The drawee, before the payment, has to examine the *Bechan* in this case in the same way as a drawee of a bill has to do in the case of an order bill of exchange. If he pays it to a wrong party he is liable to the real owner.

Dekhanhar. Dekhanhar Hundi is payable to the bearer. Here, the drawee is not required to take any extra trouble. Any one presenting the Hundi gets the payment.

Jokhami Hundi. There is one more type of Muddati Hundi—namely, Jokhami Hundi. It arose out of a sale transaction, when goods were to be sent to another town by generally river-transport. The carrier, here, acted as an insurer, and financier, as well. The seller drew the Hundi on the

purchaser favouring the carrier, who made the payment of the Hundi to the drawer on receipt of the goods for transport after deducting (i) his charges for carriage of the goods, (ii) premium for undertaking the risk, and (iii) discount for paying the money before the Hundi was paid up. The carrier in his turn got the payment of the Hundi from the drawee on safe delivery of the goods to him. In case, he lost it, he did not present the Hundi. Such Hundis are not used these days due to the emergence of three different agencies instead of one, *i. e.*, a common carrier, an insurer, and a banker.

A SPECIMEN HUNDI

Sidh Shri Mirzapore Shubhasthane Shri Pattri Bhai Sitaram Ramnath jog likhi Prayagraj se Radhika Prasad Radha Mohan ki ram ram banchane. Aparanch Hundi kini ek ap upar rupia 200 ankre do sau ke nima ek sau ke dune pure dena. Yahan rakhe Bhai Panna Lal Shambhunath Benares wale ke Miti Phagun badi Panchami dam dhanijog bina jabta bazar chalan hundi ki rit thikane lagaye chaukas kar dena. Miti Phagun badi 5 Sambat 1996.

REVERSE SIDE

Nime ke Nime rupia pachas ka chauguna pura rupia chaukas kar dijo.

200

Pattri Bhai Sitaram Ramnath Mirzapore.

Q. 89. Analyse the definition of a cheque, and point out in what respects it differs from a Bill of Exchange and a Promissory Note.

(U. P. 1936)

A. **Definition.** A cheque is an unconditional order in writing drawn upon a specified banker signed by the drawer, directing the banker to pay on demand a certain sum in money to or to the order of a person named therein or to the bearer, and which does not order any act to be done in addition to the payment of money.

Analysis. Though every word in the above definition is important, on analysis we find the following salient points :—

(1) It must contain an order.

(2) The order must be unconditional.

(3) It must also be in writing.

(4) The order must be addressed to a particular bank.

(5) It must be signed by the drawer.

(6) It must require the payment to be made on demand. No time is to be given.

(7) The amount ordered to be paid must be a sum certain in money.

(8) Payment must be ordered to be made to a person named therein or his order or the bearer of the instrument.

(9) No other act is required to be done excep that of the payment of money.

Points of difference from a B/E :—

(1) A cheque must be drawn on a banker

bill can be drawn on an individual firm, or company—merchant or otherwise.

(2) A cheque must be payable on demand. A bill may be payable either on demand or some days or months after date or sight.

(3) A cheque is generally inland.

A bill may be both an inland or foreign. As a corollary to this, a cheque is drawn in one's own currency. A bill may, on the other hand, be drawn in a foreign currency.

(4) A bill requires an acceptance, unless it is payable on demand. A cheque, being payable on demand, does not require acceptance at all.

(5) The drawer and endorsers of a bill are discharged from liability, if the holder fails to present it to the acceptor at the due date. The drawer of a cheque is not discharged by the holder's failure to present it in due time unless the bank fails.

(6) The acceptor or, in case of his failure to pay, the drawer is required to pay the amount of a bill at the due date to the holder. The banker does not pay in case payment is stopped by the drawer, or he learns the fact of his bankruptcy or lunacy or death.

(7) Cheques may be crossed. Bills can never be done so.

(8) If a domiciled bill is paid by a banker and one of the endorsements on it comes out to be forged, he cannot debit the amount to the account of the acceptor. But he can do so in case of a cheque provided he has acted as laid down in the clause giving him this protection—

in good faith, without negligence, and in due course.

(9) Notice of dishonour is necessary in the case of a bill. It is not so in the case of a cheque.

(10) All bills require nothing and sometimes protest if they are dishonoured; cheques do not require these.

Points of difference from a Promissory Note. (1) A cheque is written by a creditor. A promissory note is written by a debtor. As a natural corollary to this we can say that a cheque is an order to pay while a promissory note is a promise to pay.

(2) There may be more than two parties to a cheque. There are only two parties to a promissory note—drawer and payee—there is no drawee.

(3) A cheque is payable only by a particular bank. A promissory note may be made payable by several parties jointly or jointly and severally.

(4) Cheques are more frequently used than promissory notes, and hence they form an important media of circulation. Promissory notes do not act in this way.

(5) A cheque is always payable on demand. A promissory note may be paid even after the lapse of a certain period.

Q. 90. (a) What do you understand by 'Endorsements'. Discuss the legal significance of endorsements.

(b) Advise how the following cheques are to be endorsed :—

(*1*) *A cheque payable to the Board of High School and Intermediate Education, U. P.*

(*2*) *A cheque payable to Mrs. Jaidhari Lal Misra.*

(*3*) *A cheque payable to Captain G. Bhargava, I. M. S.*

(*4*) *A cheque payable to W. Robinson or bearer.*

(*5*) *A cheque payable to Mr. Ram Din* (*the name of the payee being Ram Adhin*).

(*U. P. 1935*)

A. **Endorsements.** These are the signatures of the payees and parties subsequent to the payees with a view to transfer the properties contained in the negotiable instruments of credit. They are complete only on delivery of the instruments in question. An order cheque or bill must be endorsed before its property passes to the transferee. Endorsements are of different kinds – most important of which are two, *viz.*, (*a*) special or full, and (*b*) blank. Special or full endorsement is one in which the name of the endorsee is also mentioned after the signature of the endorser. Blank endorsement, on the other hand, does not require mentioning of the name of the endorsee.

Aim and delivery are essential.

Two kinds (i) special. (ii) blank.

Their legal significance. Endorsements have varied significance. They operate as discharge of the authority paying the instruments of credit. Next, they are the means of transferring credit instruments not payable to bearers. Furthermore, they act as guarantee to all subsequent holders that the endorser is liable for payment in case of dishonour by the party or parties primarily liable upon the instruments in

Discharge.

Means of transferring.

Shows the endorsers' liability.

question. We are here, however, more concerned with them as affecting the bankers. A debtor is discharged of his liability only when he has paid either to the creditor or his order. In case he pays by mistake to some one else instead of the party actually ordered to be paid, he is not discharged of the liability. But the case is quite different so far as banks are concerned. They are relieved of the liability in case they pay the cheques in good faith and in the ordinary course of business *acting without negligence* on the basis of the endorsements on them provided they purport to be those of the payees and subsequent endorsers. There is no statute regulating the form which an endorsement shall take. But we can be guided by certain decisions of the courts, mercantile usage, and our own common sense.

Bankers' priviledge.

Forms of endorsement in the cases given.

(1) It must be endorsed as :—

For the Board of High School and
Intermediate Education, U. P.,
Ram Narain Lal,
B. A., Rai Saheb,
Secretary.

(2) Ramrati Bai, wife of Mr. Jaidhari Lal Misra. It has been supposed here that the name of the wife of Mr. Jaidhari Lal Misra is Ramrati Bai.

(3) G. Bhargava, Captain, I. M. S. The suffix 'Captain' is supposed to be descriptive.

(4) W. Robinson. It may also be signed by

any other party taking the money as it is a bearer cheque.

(5) Ram Din (Ram Adhin).

Q. 91. Examine the following endorsements and indicate if they are in order, giving reasons for your answer :—

(a) A cheque payable to Miltons, endorsed 'J. Milton and Nephew'.

(b) A cheque payable to Mr. J. K. Sriwastawa, endorsed 'for J. K. Sriwastawa for J. Mehrotra," J. N. Mishra.

(c) A cheque payable to Mrs. Rajeshwar Bhargava, endorsed '(Mrs.)' Rajeswar Bhargava.

(d) A cheque payable to Sister Jane, endorsed 'Sister Jane'.

(e) A cheque payable to R. S. Mehra, endorsed 'R. S. Mehra'. (U. P. 1937)

A. (*a*) 'Miltons' means literally a number of individuals all named Milton. They may be Milton & Bros., or Milton & Son or Sons, or Milton & Nephew. In fact, it is very vague. The endorsement 'J. Milton and Nephew' may be taken as correct.

(*b*) The endorsement in question is quite irregular. First of all, a person signing on behalf of the other must specify the capacity in which he is signing. That is, in case he has been legally authorised to do so, he must indicate this authority by prefixing some such term as 'per pro' to the name of the principal. If, however, he has no such authority but is acting only because it is legal or customary for a person holding the office he holds to act on behalf of his

principal, he must indicate that office. Then an agent cannot delegate the authority conferred on him by his principal. In this case the endorsement must be made by J. Mehrotra who must also give his designation after his signature.

(*c*) A cheque payable to a married woman in her husband's name must be endorsed in her own name followed by 'wife of' and her husband's name.*

(*d*) As 'Sister' is a title given to nuns, it may be endorsed as 'Jane Sister'. Sister Jane is irregular. Title should not be placed before the name.

(*e*) The endorsement in question is quite regular. It is in the same form as given in the body and without any courtesy title added thereto.

Q. 92. Examine the following endorsements and state whether they are in order, giving reasons for your answer :—

(*a*) *A cheque payable to the Trustees of the estate of Mr. Ram Swaroop Varma,*

Endorsed :

For self and Co-trustees Sheo Shanker Lal.

(*b*) *A cheque payable to Shrimati Sushila Devi.*

Endorsed :

Shrimati Sushila Devi.

(*c*) *A cheque payable to Messrs. Harold & Co.,*

Endorsed :

For Harold & Co., J. Jones.

* Please see answer to Q. 90 endorsement No. (2).

(*d*) *A cheque payable to Mr. Cowasji Jehangir.*

Endorsed :

Cowasjee Jehangir. (*U. P. 1938*)

(*a*) This endorsement is not in order. A cheque payable to trustees must be signed by all the trustees. Bankers refuse to accept a per pro endorsement or an endorsement of a single trustee on behalf of his co-trustees. This rule is very necessary owing to the strictness with which the Courts always safeguard the interests of the beneficiaries of a trust. The knowledge, that trust funds are being dealt with, imposes on all those to whom such knowledge can be imputed the necessity of more than ordinary precautions for the prevention of fraud*. Next, it does not indicate as to the name of the trust. It must mention 'For the estate of Mr. Ram Swaroop Varma' followed by the signatures of all the trustees.

(*b*) The endorsement in question is not in order as it does not purport to be that of Shrimati Shushila Devi, as nobody uses courtesy title before one's own name. 'Shrimati' is a courtesy title. She must sign as 'Sushila Devi.'

(*c*) This endorsement is also not in order. Bankers always require the agent's signature to be followed by some designatory addition indicating the character of his agency, except when the signature is per procuration†. Hence, this must be followed by some designatory title.

(*d*) The endorsement is not in order. If payee's name has been mis-spelt, it does not matter ;

* Please Consult Sykes, 'Banking and currency,' page 143.
† Please consult Sykes 'Banking and Currency' page 139.

endorsement must also be in the same spelling. It may, however, be followed by the correct spellings within brackets, *e.g.*, Cowasji Jehangir (Cowasjee Jehangir.)

Q. 93. You are asked to make out an uncrossed order cheque for Rs. 600 on your Bank, the Allahabad Bank (Allahabad Branch), in favour of one Lala Daulat Ram of Allahabad.

Draw a specimen cheque in the above terms and describe the procedure which Lala Daulat Ram will have to follow in order to have the cheque cashed or collected. (*U. P. 1931*)

A.

A SPECIMEN CHEQUE

No. 232 Dated July 15, 1940.

ALLAHABAD BANK LIMITED,

ALLAHABAD BRANCH

Pay to Lala Daulat Ram *or Order*| *Rupees* Six hundred only.

Rs. 600. Ram Narain Lal

Presentation by self. **Procedure to be followed.** L. Daulat Ram, in order to encash the cheque, may himself go to Allahabad Bank, Allahabad branch. In that case he will sign his same in the same spellings as have been given here in the body. If the clerk-in-charge knows him, he will make the payment. Otherwise he shall have to be satisfied as to his identity. In India ledger keepers only pass the cheque after examining it, and finding out from the account of the drawer if sufficient balance is available there. It then passes through the accountant and agent and is

Signature.

Identity

Examination by ledger keepers, accountant, and manager.

finally paid by the cashier. If, however, Lala Daulat Ram does not wish to go himself to the bank, he may endorse it in favour of one of his servants in blank or in full. If it has been endorsed in full, the servant shall have to satisfy the banker with regard to his identity. [For endorsements answer to question 48 may be referred to.] Lala Daulat Ram may also deposit it in his account, if he has got one. If the account is with Allahabad Bank, there will be no difficulty. In case, however, it is with some other bank, that bank will, first of all, collect the cheque and then give credit to Lala Daulat Ram's account. Lala Daulat Ram shall have to enter it in his pay-in-slip book in order to deposit it in his account and send it to his bank. No commission is charged for collection of local cheques.

Payment by cashier.

Presentation through somebody else.

Depositing in his account.

Entry in Pay-in-ship book.

Q. 94. Discuss the liability of a 'paying banker' with regard to the payment of a cheque.

(*U. P. 1938*)

A. **Liability of a paying banker.** The paying banker must see that the cheque upon which he is making the payment is regular in all respects. For instance, he must ascertain that the signature on it is that of the drawer himself. It must conform with the specimen signature in the autograph book. If there is any mistake and the banker pays on a forged signature, he is not allowed to debit the amount to his customer's account. There is also a responsibility on the customer too, to see that he does not facilitate the forging of his signatures or the payment of a cheque bearing forged signatures. A banker cannot also debit his customer, if

Regular.

Drawer's signature.

Post-dated cheque.

he pays a cheque before the date it bears, so long as the date does not arrive. In case, the customer becomes bankrupt, or lunatic, or dies in the meantime, he loses the amount so paid. Besides, if a post-dated cheque has been paid, and due to this payment there is no sufficient balance left to enable the banker to pay a regular cheque, he cannot dishonour it. The regular cheque must be honoured, if there would have been sufficient balance to enable the banker to honour it, had the post-dated cheque been not paid up. Moreover, the customer has got the right to stop the payment of a cheque before its due date. In case he does so, the banker stands to lose if he has already paid it. Again, a banker must pay the cheque to the person named in it or to his order except in the case of a cheque payable to bearer. The evidence of proper payment is the endorsement of the payee or endorsee. But special protection is afforded to the banker in this respect. It is to the effect that if a banker pays a cheque drawn upon it in good faith and without negligence, in the ordinary course of business, it is not incumbent upon him to show that the endorsement or endorsements were made by or under the authority of the person or persons whose endorsement or endorsements it or they purport to be. The question whether a particular endorsement purports to be that of the person by or under whose authority it was required to be made is, however, difficult of answer. But the bankers answer it by exercising their own common sense, in the light of certain decisions of the courts and mercantile usage. The terms 'in good faith', 'without negligence', and 'in the ordinary course of business' are very important. Payment

Endorsement.

of a crossed cheque to any one, not a banker, would not be in due course. Or, again, the payment of a cheque, after or before the business hours, is not in due course. The banker has to be extra cautious in making payment of cheques drawn in connection with Trust Funds. If he has got the least doubt to the effect that such funds are being mis-appropriated, he must not make the payment unless his doubts have been cleared. Again, he should exercise great care in his dealings with employees and other agents of his customers. Further, he must pay the amount written on the cheque. If there arises any doubt, and it is suspected that some alteration has been made, this should be confirmed before making the payment. If the amounts in words and figures differ, the amount in words may be paid. But it will be better, if it is referred to the drawer. If there is no balance left in the customer's account to enable the payment of a cheque to be made, it may be returned unpaid. If, however, an arrangement for an overdraft has already been made, the cheque must be honoured. Such an arrangement cannot be cancelled without giving notice. If a banker has made a mistake in striking out the balance of a customer's account, and the customer acting on the basis of such a balance has drawn a cheque, the banker must honour it. He has, however, got the right to claim the amount from his customer. The banker has to obey all commands of his customers stopping payments. He should also not pay in case he learns of his customer's death, insolvency or lunacy. Payments should also be stopped in case a garnishee order has been served by the court.

Crossed cheque.

Payment within business hours.

Trust Funds.

Employees. etc.

Amount.

Balance.

Over-draft.

Error.

Stopping payment.

Death, insolvency lunacy &

Granishee order.

Q. 95. What precautions should the paying banker observe in paying cheques drawn upon him.

(U. P. 1935)

A. Answer to this question can be given with the help of the answer to question 94.

Q. 96. Indicate and explain some of the grounds on which the banker usually refuses payment of cheques.

(U. P. 1936)

A. **Grounds on which the banker usually refuses payment of cheques.** The following are some of the grounds on which the banker usually refuses payment of cheques.

(1) **Refer to drawer.** This is a very vague term. It means that there is something wrong with the cheque. It is usually put down in case there is no sufficient fund to the balance of the drawer's account.

(2) **Not arranged.** This means that the customer's particular account, on which the cheque has been drawn, has not got sufficient balance to enable the banker to make the payment, though there is balance in other accounts and payment could be made, had a transfer been arranged for by the drawer.

(3) **Effects not yet cleared, please present again.** It sometimes happens that a cheque is presented for payment just at the time when the drawer has paid into his credit certain cheques which have not been cleared. Under such circumstances, the cheque is returned with the above remark

(4) **Exceeds arrangement.** This again shows shortage of funds. It may be possible that the amount of the cheque is more than the amount of the overdraft available or the amount of the transfer from other accounts is available.

(5) **Insufficient funds.** This clearly shows that the funds are not sufficient to enable the payment of the cheque. This remark should be avoided as far as possible. Remark number (1) may be used to indicate it.

(6) **Full covers not received.** This is another remark meaning the same as (5).

Payment stopped by the drawer. The term is self-explanatory. This can be indicated only if it is so.

Drawer's signature differs. The banker keeps an autograph book in which it has the specimen signatures of all the customers. When a cheque is presented to the bank, the signature on it is confirmed with the specimen signature in the autograph book. The term indicates that the two signatures differ.

... ..**Payee's endorsement incomplete or required or irregular, or illegible.** In the blank space is filled 1st, 2nd, 3rd, etc., as the case may be. This indicates that endorsement of the particular payee is incomplete or required or irregular, or illegible. 'Complete endorsement' means signature along with all the suffixes as given in the body of the cheque or in subsequent endorsements. 'Irregular' means not according to the regular practice.

Endorsement requires bank's guarantee or confirmation. In case a cheque is presented through a bank, and there is any doubt

with regard to a particular endorsement it may be referred back to the collecting bank for guarantee or confirmation. In case of its turning out to be forged later on, the collecting banker is held responsible.

Drawer's signature required. This remark *may be put in case the drawer has missed to sign.*

Cheque is *multilated, post-dated,* or out of date. A mutilated cheque is not paid. Similarly a post-dated cheque is not *paid so long as the date given on the cheque does not arrive.* A cheque more than *6 months old becomes out* of date and is not to be honoured without the consent of the drawer.

Amount in words and figures differ. The banker may pay the amount in words, but he can also return the cheque in this case with the above remark.

Crossed cheque must be presented through a bank. A crossed cheque cannot be paid to anybody else except a bank.

Clearing stamp required. The clearing bank ought to put its stamp. In cases it does not do so, the cheque may be returned.

Alteration requires drawer's confirmation. Even a slight alteration must be initialed by the drawer. If it has not been done so, the cheque must be returned.

Drawer deceased. A banker cannot pay a cheque on receiving the information of his customer's death.

Drawer declared bankrupt. This remark

should be made only after having made full confirmation of the fact,

Garnishee order served. In case court has stopped payment, the cheque cannot be honoured.

Type-written cheque. A typed cheque is not paid by banks.

Q. 97. Discuss the liabilities of (a) a paying banker, and (b) a collecting banker, in respect of a crossed cheque. *(U. P. 1939)*

A. **Liability of a paying banker in respect of a crossed cheque.** The liability of a paying banker in respect of a crossed cheque is the same* as in respect of an ordinary cheque, with the only exception that it should be paid to none but a banker. Its payment to any one else will not be in the ordinary course of business and hence under such circumstances the banker will not be entitled to receive the protection granted to him by Section 85 of the Indian Negotiable Instrument Act and Section 60 of the English Bills of Exchange Act, 1862. These sections protect him against payment on cheques bearing forged endorsement or those made without authority where they purport to be endorsed by or on behalf of the payee or subsequent endorsees, although they may not be so.

The same as is in the case of an ordinary cheque except that it should be paid only through a bank.

Liability of a collecting banker in respect of the same. The following section determines the liability of a collecting banker in respect of a crossed cheque. "Where a banker in good faith and without negligence receives payment for a customer of a cheque crossed generally or specially to himself he shall not in

(i) In good faith and without negligence.
(ii) For a customer.
(iii) Crossed cheque.

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*Please consult answer to Q 94 on this topic.

case the customer has no title or a defective title thereto, incur any liability to the true owner by reason only of having received such payment".

Only those having current account. are regarded as customers.

It is quite clear that the payment of a crossed cheque must be received for a customer only in order to obtain protection granted under this section. If a banker collects a crossed cheque for one who is not his customer, the protection granted under this section cannot be given to him. Whether a particular person is a customer of the bank or not will depend on the fact whether he has a current account with it or not. Only those having current accounts are deemed to be the customers of the bank. The terms 'in good faith' and 'without negligence' bear the same importance here as anywhere else*.

Q. 98. Under what conditions can a banker dishonour without liability (a) his customer's cheques, (b) domiciled bills ? (*U. P. 1940*)

A. **A banker can dishonour his customer's cheques without liability under following conditions.** (1) If they are not regular. This means, (*a*) if the signature of the drawer on the cheque does not coincide with the specimen signature with the bank, (*b*) if the cheque is post-dated or out of date, (*c*) if the amount in words and figures differs, or if it is in any way not clear, (*d*) if the cheque is incomplete in any way or if there are alterations which have not been initialled by the customer, (*e*) if it has been written with pencil or typed, and (*f*) if it is mutilated. (2) If endorsements on them are

*Please consult answer to Q. 94.

irregular. This includes incomplete endorsements, absence of an endorsement or endorsements. (3) If a crossed cheque is not presented through a bank or if it does not bear the collecting banker's clearing stamp. (4) If there is no sufficient fund at the time of their presentment in the account of the customer to enable payment. In case, however, an arrangement for an overdraft has been made, the cheque drawn on the basis of such an overdraft cannot be dishonoured. If the banker wants to cancel the arrangement, he must give notice to the effect to the customer in time. Further, if the banker has wrongly struck the balance in the Pass Book, acting on the basis of which the customer has drawn a cheque, it must be honoured. The banker has, however, a claim against the customer to receive payment. (5) If the payment has been stopped by the customer himself or by a court of law under what is known as a garnishee order. (6) If the customer has died, or become lunatic or has been declared bankrupt.

He can dishonour domiciled bills under following conditions without incurring any liability thereon. (1) A banker has ordinarily no obligation to honour a domiciled bill unless and until it is expressed or implied in any way. In case he has been honouring such bills for sometime, the obligation is implied, and they must be honoured so long as sufficient notice cancelling the obligation is not given by him, (2) if it is not in proper form, (3) if it is not duly stamped, (4) if it is presented before the date of maturity, (5) if there are any material alterations on it and they have not been confirmed by the drawer, (6) if the acceptor's signa-

tures are forged, and (7) if the signature of the payee or that of any subsequent endorsee is forged. A banker has not been given protection against payment of domiciled bills bearing forged endorsements as has been given against that of cheques. (8) He will also not pay a bill if the acceptor has been declared bankrupt. (9) On the death of the same also, he must refer to the successors of the deceased.

Q. 99. Explain how the crossing of a cheque offers protection to the holder. Discuss, in this connection, the significance of a cheque crossed—(a) Not Negotiable, (b) Account Payee only. *(U. P. 1937)*

May lead to the trace of the defaulter.

A. **Protection offered to a holder by the crossing of a cheque.** As a crossed cheque is payable only through a bank, the holder on losing it, can, get it traced. The collecting banker must have collected it for one of his customers. In case this customer has no title to the said cheque, the holder can have a recourse against him. If, however, his title is good, he may at least be able to tell him the name of the party from whom he has received it. This may ultimately lead to the discovery of the person having no title to the instrument. Further, if it turns out that the collecting banker had collected it for one who was not his customer, he may himself be held liable, if he was not holder in due course.

Collecting banker may himself be held liable.

A crossed cheque will, however, offer further protection in case it had been crossed 'Not Negotiable.' A cheque is a Negotiable Instrument, ***i. e.,*** the transferee gets a good title from the transferrer even if his title is bad, provided

he takes it in good faith, for a valuable consideration, and in a complete form. But in case the term 'Not Negotiable' is written within the crossings of a cheque, the same becomes Not Negotiable, *i. e.*, the transferee receives the same title from the transferrer as he has. This means that the title of the last payee of such a cheque will not be better than that of the transferrer. In fact, no transferrer can pass a better title to the other than his own if the instrument has been made Not Negotiable. Under the circumstances the holder shall be able to claim the money back from the last payee.

Change in the title.

Account Payee only. The insertion of this term within the crossing only means that the collecting banker should place the amount of the cheque on collection of the same to the credit of the payee's account, and not pay it to anybody at the counter. This may only help the holder to recover the amount, but there is nothing to check the payee from immediately taking the amount from the account by means of a fresh cheque. Hence, these words have no legal significance.

Greater possibility of the recovery of money.

Q. 100. Define a cheque, and bring out clearly the significance of the term 'negotiable instrument'. Show the various devices by which a cheque can be protected in spite of the cheque being a negotiable instrument. (*U. P. 1939*)

A. For definition, please consult answer to Q. 89 on this topic.

For the significance of the term 'Negotiable Instrument' please consult answer to Q. 99, sub-heading 'Not Negotiable'.

Devices for protecting a cheque. First

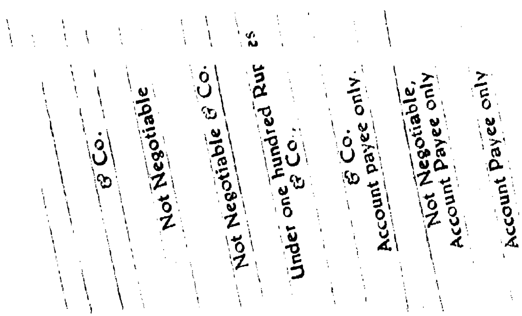
Order cheque. of all, it should be made payable to the payee only or to the order of the payee. Such a cheque will offer a better protection inasmuch as it would require an endorsement before its negotiation. This may lead to the trace of the culprit. Crossing. *Next, it may be crossed specially.* This will require the paying banker to make the payment through a bank. No bank will receive payment for notorious people. In case, however, Not Negotiable. payment is made, it may be recovered. If, over and above this, the term 'Not Negotiable' is inserted within the crossing it offers a further protection*.

Q. 101. What is the difference between a bill of exchange and a cheque? Give various forms of crossings on cheques, and explain why cheques are crossed. *(U. P. 1933)*

A. For difference between a bill of exchange and a cheque please consult answer to Q. 89 on this topic.

Various forms of crossings on cheques are as under :—

(1) General Crossings



1 2 3 4 5 6 7 8

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* The answer to this question can better be given by discussing the salient points given in the answer to Q. 99 on this topic.

(2) Special Crossings

Forms Nos. 1, 3, 7, and 8 with the name of some bank within the crossings.

It offers additional protection.

Reason for crossing. Crossing indicates that the payment of the cheque is to be made by the paying banker not on the counter to the payee but through some bank. In case of special crossing the name of the bank through which the payment is to be made is also given. This is done in order to offer protection to the holder of a cheque. A banker will not collect a cheque for anybody and everybody. Mostly he will do it for his customer. Insertion of the term 'Not Negotiable' offers additional protection to the holder.*

Q. 102. Explain clearly the functions of (a) a cheque, (b) a bill of exchange, and (c) a bank draft. Point out the significance of the term 'negotiable instrument.' (*U. P. 1942*)

A. **Functions of (a) a cheque.** The following are the functions of a cheque :—

(1) It provides a convenient method of payment and does away with the necessity of handling coins or notes. It is discharged by a bank.

(2) It provides an evidence of payment which can be called, if necessary, in a court of law.

(3) Being a negotiable instrument, it can be transferred by the holder in settlement of his own debt without the use of coins or notes.

*A detailed answer to this question can be written with the help of the answer to Q. 99 on this topic.

(4) It facilitates transfer of money from one place to another. If some amount is required to be paid in a different town, a cheque can be sent through post, and will be honoured on presentation in some bank on the receipt of the information to the effect that the drawee bank has placed the amount to the credit of the collecting bank.

(5) It supplements legal tender money so long as it is not presented for payment in hard cash, and hence minimises price fluctuations.

Functions of (b) a bill of exchange. The following are the functions of a bill of exchange :—

(1) It provides a convenient and safe method of settling debts, as it does away with the necessity of sending coins or notes. It is generally discharged through a bank.

(2) It fixes the date of payment, and the creditor can be sure of its payment on the due date.

(3) It is a legal evidence of a debt, which can be realised through a court of law.

(4) Being a negotiable instrument, it can be transferred by the holder in settlement of his own debt without the use of coins or notes

(5) It enables the holder to obtain cash whenever he wishes to do so, as he can get it discounted at a discounting house or bank at any time after its issue.

(6) It gives the acceptor time to sell the goods

in consideration of the purchase of which it usually arises, and thus obtain necessary funds to pay it at the time of maturity.

(7) It provides a convenient media of exchange for settling foreign debts.

(8) It supplements legal tender currency, and thus minimises price fluctuations.

Functions of (c) a bank draft. The following are the functions of a bank draft :—

(1) A bank draft is used for transference of money within a country and outside it.

(2) It provides an evidence of payment in far off places as well.

(3) It economises the use of legal tender money and bullion, which would have been required in its absence.

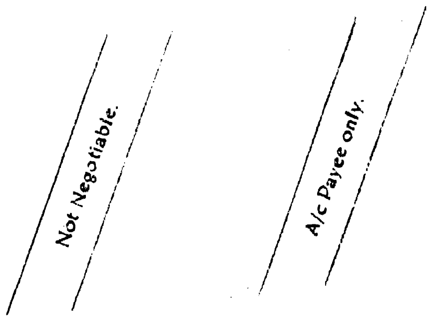
Significance of the term 'negotiable instrument.' The significance of the term 'negotiable instrument' is that the transferee of the same gets a good title from the transferrer even if his title is bad, provided he takes it in good faith, for a valuable consideration, and in a complete form. A cheque, a bill of exchange and a bank draft—all are negotiable instruments, *i.e.*, they can be easily transferred, as the transferee gets in their cases a good title to the instrument provided of course it cannot be proved that he had not taken it in good faith, or obtained it without a valuable consideration or in an incomplete form.

Transferee get a good title.

A cheque, a B/E, and a bank draft, all are negotiable instruments.

Q. 103. What is a 'negotiable instrument'? Explain and contrast the advantages or disadvan-

tages of the understated crossings as used in connection with cheques :—



(U. P. 1943)

Transferee gets a good title.

A. **Meaning of a negotiable instrument.** A negotiable instrument means a cheque, a bill of exchange and a promissory note, in the case of the transference of which the transferee gets a good title to the instrument even if the transferer's title thereto is bad ; provided of course he obtains it in good faith, for a valuable consideration and in a complete form.

A not negotiable crossing indicates that the transferee's title will depend upon that of the transferer.

Explanation of 'not negotiable' and 'A/c Payee only' crossings. In case the term 'not negotiable, is written within the crossings on the face of a cheque, it becomes not negotiable, *i. e.*, the transferee receives the same title to the cheque from the transferrer as he has. This means that the title of the last payee of the cheque will not be better than that of the transferrer. In fact, no transferrer can pass a better title to the other than his own if the instrument in question has been made not negotiable. Under the circumstances, the holder shall be able to claim the money back from the payee previous to him.

The insertion of the term 'A/c Payee only' within the crossings on the face of a cheque means only that the collecting banker should place the amount of the cheque to the credit of the payee's account after its collection, and not pay it to anybody at the counter. But there is nothing to check the payee from withdrawing the money immediately after its having been placed to the credit of his account.

In the case of an a/c payee onsy crossing, amount is required to be credited to the payee's a/c.

Advantages and disadvantages of the above crossings. From what has been said in connection with a not negotiable crossing, it is apparent that the true owner of the money contained in the instrument under reference can obtain it from the payee provided he is successful in proving that the party subsequent to him and transferrer of the instrument had no good title to it. But this is not possible in the case of a cheque bearing A/c Payee only crossing as the cheque is not thereby rendered not negotiable.

In the case of a not negotiable crossing, amount can be claimed, but in the other case, it cannot be so.

As against this, it may be said that the true owner may be able to recover the amount more easily in the latter case where there are greater chances of its not having been withdrawn. But this is only in theory. The cheque being a negotiable instrument, unless and until it is made not negotiable, the payee cannot be debarred of his claim to the money contained in it.

The fact of the easy recovery of money in the case of a/c payee only is also only in theory.

Q. 104. On most printed credit slips issued by bankers you will find a request similar to the following: 'Customers are requested to cross all cheques before paying them in.' What is the reason for this request? (b) A customer of a branch bank asks for a draft of the branch upon its head office for Rs. 500; and requests the branch to make it

payable to bearer. Are there any objections to issuing such a drafts, and, if so, what are they?

(U. P. 1941)

The aim is to get protection under sec. 131 of the I. N. I. Act.

A. (*a*) **Customers are requested to cross all cheques before paying them in.** This request is made with a view to take advantage of the protection afforded to a collecting banker in case the title of the customer to the cheque proves defective. Sec. 131 of the Indian Negotiable Instruments Act lays down that 'A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not in case the title to the cheque proves defective incur any liability to the true owner of the cheque by reason only of having received such payment.' If the cheque paid in is uncrossed, this protection is not available to the banker. He is then treated by law only in the capacity of an agent to the customer, and hence his title depending upon that of the customer, he is held liable to the true owner of the cheque in case the title of the customer proves defective.

This protection is not available, in case of an uncrossed cheque.

Payment to a wrong party is avoided.

It is also laid down with a view to avoid payment of the cheque in question to a wrong party. As is well-known, when cheques are sent for collection and deposit, they pass through a number of hands. There are the employees of the banks too. Any one of these may obtain the payment of the cheque or cheques in question for himself. But this is not possible, if they are crossed, as such cheques are required to be paid only to a bank, and in case they fall in the hands of an employee of the bank, they cannot be cashed for their own selves.

(*b*) **A bank draft payable to bearer.** Such a draft cannot be issued because Section 25 of the Indian Paper Currency Act (1923) of which the relevant portions still hold good prohibits the issue of private bills or notes payable to bearer on demand. It lays down as follows: 'No person in British India shall draw, accept, make or issue any bill of exchange hundi, promissory note or engagement for the payment of money payable to bearer on demand, or borrow, owe or take up any sum or sums of money on the bills, hundis or notes payable to bearer on demand, of any such person: provided that cheques or drafts payable to bearer on demand or otherwise may be drawn on bankers, shroffs or agents by their customers or constituents in respect of deposits of money in the hands of those bankers, shroffs or agents and held by them at the credit and disposal of the persons drawing such cheques or drafts."

Section 25 of the I. P. C. Act prohibits the issue of such a draft.

The draft under reference is to be both demand and bearer. But at the same time, it is not to be drawn on the bank by its customer for a sum held by the former. Quite contrary to this, it is to be drawn by a bank upon its own self. Hence it cannot be issued without contravening the provisions of the section referred to.

APPENDICES

I

SHORT NOTES

Acceptance. A bill of exchange after being accepted by the drawee is known as an acceptance.

The act itself is also known as acceptance. The same may be signified either by simply signing one's name across a bill or along with the word 'accepted'. In case the drawee does not agree to all the terms of the bill he may accept it conditionally by laying down the modification of the terms before signing. Such an acceptance is known as a *Qualified Acceptance.*

Endorsement. Please refer to Endorsements in answer to Q. 90.

Post-dated cheques. Cheques bearing future dates are known as post-dated cheques. These are not honoured by banks so long as the dates of the cheques do not arrive.

Stale cheques. Cheques bearing dates of six months or more than six months back are known as state cheques. They are not honoured by banks.

Letter of credit. A letter of credit is a letter issued by a banker in the name of another banker or his own correspondent authorising him to honour the drafts of a person or pay him to a certain extent according to the terms given therein. It also contains the direction as to the way of indicating that he has done so and the method of re-imbursement. In case, it is written in the names of a number of persons it is termed as *a circular letter of credit.*

Letters of credit may be of different forms. But two are the most important, *viz.*, (1) a letter wherein one banker or merchant requests another to hold a certain sum at the disposal of a third person, and (2) a letter wherein one banker requests another merchant to supply goods to a

third person to a certain extent and re-imburse himself by drawing a bill upon the said banker which he promises to honour. The former is known as the *Personal Credit Letter* or a *Travellers' Facility Letter* or a *Travellers' Letter of Credit*, while the latter is known as a Commercial Credit Letter. In the case of a Travellers' Letter of Credit, money is usually deposited with the issuer, and in that of a Commercial Credit Letter it is promised to be paid to him before the due date of the bill.

A Commercial Credit Letter may be revocable (unconfirmed) or irrevocable (confirmed). In case, it is a *Revocable* (unconfirmed) *Letters of Credit*, the banker has got the right to revoke it at any time but generally what is done is to give a notice before doing so. In case, however, it is an *Irrevocable* (confirmed) *Letter of Credit*, once it is issued, it cannot be revoked except of course with the consent of the person in whose name it has been issued.

Commercial Letters of Credit are needed specially by merchants importing goods from foreign countries. These are sent along with the indent. When orders are placed by Indian merchants upon foreigners (in England or any other country) or by foreigners upon Indian merchants, importers are generally required to open what is known as a *London Acceptance Credit*, in which case some Accepting House or bank in London agrees to accept the importer's bill on behalf of the exporter. Goods are exported by foreign merchants and bills are drawn on the bankers or merchants agreeing to accept them which is the same as issuing a letter of credit. Thereafter the exporters

get these bills discounted with their own banks on the guarantee of the letters of credit or London Acceptance Credits which they hold from the Accepting Houses or banks and in which the latter undertake to accept and pay the said bills. Along with the bills are handed over the shipping documents connected with them, and on receipt of these the Accepting Houses or banks accept or pay the bills according as they are D/A or D/P. In case of D/A bills (Documents against acceptance), bills are only accepted at the time of the delivery of the documents and in case of D/P bills (Documents against payments), bills are paid.

Letters of Credit may also be *Revolving* or say *Running*. In this case, the amounts for which they are originally issued are automatically renewed from time to time as the bills under credit are issued or paid, for example, (1) if the amount is Rs. 1,000, and two bills of Rs. 500 each are drawn, as soon as any one of them matures and is paid a fresh bill or bills for or upto Rs. 500 may again be drawn, (2) if the amount for one draft is Rs. 1,000 or less, and a draft for this or less than this amount is drawn, as soon as it matures and is paid, another draft for any amount but not exceeding Rs. 1,000 may again be drawn, and (3) if the amount of one draft to be issued is Rs. 1,000 or less and a draft for this amount is drawn, the credit is automatically renewed and another draft for this or less than this amount may again be drawn.

Hundi. It is an instrument resembling a bill of exchange in its essentials. It has been in use in India for long. It is written in various Indian languages. The phraseology of a hundi is

very interesting. It begins with a salutation and ends with a subscription and hence is in the form of a letter. [For a detailed description, please refer to the answer to Q. 88.]

Acceptor. One who accepts a bill of exchange is known as an acceptor. Generally, the acceptor of a bill of exchange is its drawee. In case he is somebody else, he is known as the *acceptor for honour*. In fact, the primary liability of a bill of exchange is that of an acceptor and he is ultimately liable for honouring it.

Holder of a bill. The holder of a bill may be original payee named in the bill or any person to whom the bill has been endorsed by him or any other subsequent payee. Mere possession of a bill is not an attribute of a holder. He should, in fact, have the right to own it. Even if a bill is not in existence, say, if it has been burnt up, the party owning it prior to its having been burnt shall be deemed to be its holder.

Payer for honour. One paying in discharge of a negotiable instrument in spite of his not being liable upon it in any way is known as a payer for honour. He may have paid it in order to save the honour of any of the parties liable thereupon. A payer for honour has the right of recovering the amount of the instrument from the party for whose honour he has paid.

Noting. The holder of a bill is required to present it to the drawee or the acceptor, as the case may be, after its having been dishonoured by him through a notary public who notes down the reason for dishonouring. Such a note must be made within a reasonable time after dishonour and must specify the date of dishonour, the rea-

son, if any, assigned for such dishonour or, if the bill has not been expressly dishonoured, the reason why the holder treats it as dishonoured. The object of doing this, is to have an official record of the refusal to honour the bill.

Cheque crossed Not Negotiable. Please refer to the answer to this part of the Q. 99.

Accommodation bills. These are the bills drawn and accepted for raising money in order to obtain finances for a temporary period by discounting them with a banker. For instance, if A is in need of Rs. 500 for a period of 3 months, he may draw an accommodation bill upon B whom he prevails upon to accept it. This, then, is discounted with a bank and the proceed is utilised in the way desired. Just before the date of maturity A has to send the money to B in order to enable him to meet the bill. The proceeds may also be shared equally or in any other proportion between the drawer and the drawee, if both need accommodation. The drawer, in this case, has to send only his portion of the amount taken along with the proportionate charges for discounting. There is, however, nothing to distinguish an accommodation bill from a genuine bill, neither is it illegal in any way. The drawee has to meet it, and in case the drawer does not make the payment, he has a right to obtain it from him.

Conditional acceptance. [Please refer to Acceptance.] A qualified acceptance may be of several types. It is conditional, if its payment is made dependent by the acceptor upon the happening of a particular event or upon the ful-

filment of a certain condition, *e. g.*, accepted payable on the delivery of the railway receipt.

Protest. A foreign bill requires to be protested under the laws of certain countries. Protest is a certificate granted by the Notary Public to the effect that the particular bill was presented to the drawee but was dishonoured. There is a certain form of this protest and this is to be adhered to.

Allonge. When endorsements on a particular cheque, bill of exchange or promissory note have become so numerous that there is no space left on its back for the holder of the same to make a further endorsement, he may affix to it a sheet of paper for doing so. The first endorsement is so made as to appear on both the instrument and the attached paper to ensure safety. This extra sheet of paper thus attached is known as *Allonge.*

Acceptor for Honour. Please consult acceptor.

Negotiable Instrument. Please consult answer to Q. 103 under this heading.

I. O. U. In I. O. U. is a written acknowledgment of a debt due from one person to another ; so called because it commences with these letters which are substituted for the words 'I owe you' having the same sound. An I. O. U. bears the date, the name of the creditor, the amount of debt and the signature of the debtor, It does not require a stamp. It is not a negotiable instrument.

Treasury Bills. Short-term borrowings are made by Central and Provincial Governments

in the form of Treasury Bills. They are borrowings for not more than 12 months in any case. Tenders for Treasury Bills are invited every week by the Central Government and those offered at the lowest rate of interest are accepted to the extent required. The period for which they have to run is known as *Usance*. Interest on these bills is paid by means of issuing them at a discount. They are also issued, if necessary, within less than a week. Such bills are known as *Intermediate Treasury Bills.*

Bank acceptances. Please consult Bank Bills in Q. 85.

Jokhami Hundis. Please consult this heading in answer to Q. 88.

Endorsement in blank. Please consult Endorsement in the answer to Q. 90.

Holder in due course. A holder in due course is a holder, who has taken a negotiable instrument, *e. g.*, a cheque, a bill of exchange, and a promissory note—complete and regular on the face of it under following conditions :—

(1) That he became its holder before it was overdue, and without notice that it had been previously dishonoured, if it was dishonoured.

(2) That he took it in good faith and in return for some consideration, and without any knowledge as to any defect in the title of the party negotiating it.

He can sue in his own name and recover the amount due thereon.

Postal Order. This is an order from one post office upon another to pay a sum certain in money to the order of the person named therein or to the bearer of the instrument. These may be British or Indian. British Postal Orders are drawn by one Indian postal office upon a British post office for sums varying from 6*d.* to 21*s.* in multiples of 6*d.* There is a blank space on every postal order to affix stamps if fractions are involved, *e. g.*, for remitting 7*d.*, a postal order of 6*d.* with a stamp for 1*d.* affixed on it shall have to be sent to the payee, who will obtain the amount from the particular post office named therein. The name of the post office is also filled in by the remitter. Indian Postal Orders are issued in denominations of annas eight, rupee one, rupees five and rupees ten only. A fee of anna one is charged per postal order whether British or Indian.

II

SUPPLEMENTARY QUESTIONS

1. Define a Negotiable Instrument. Give standard forms for a (i) Cheque, (ii) Promissory Note, (iii) Bill of Exchange. *(Raj, Board).*

A negotiable instrument is one whose title of ownership passes by endorsement or mere delivery, and a holder for value of the same has a right to retain it against the real owner even if it had been lost by or stolen from him.

For a specimen form of a cheque please refer to the answer to Q. 93.

Specimen form of a Promissory Note

Allahabad.

September 29, 1940.

Stamp
2 as. Rs. 500/-

One month after date I promise to pay to Syt. Shiama Charan Avasthi, the sum of rupees five hundred, value received.

Om Prakash.

A specimen Bill of Exchange.

Calcutta.

September 25, 1940.

Stamp
2 as. Rs. 1,000/-

Three months after date, pay to us or our order the sum of rupees one thousand only, value received.

Sheo Nath Ram Das.

2. What are the respective liabilities of the drawer, acceptor and endorsers of a bill of ex-

change, when the bill is accepted (*a*) for value, and (*b*) for the accommodation of the drawer ?

This question can be solved with the help of answer to Q. 86 and short note on accommodation bills.

3. A has an account with the X Bank Ltd. A thief steals his cheque book and also a cheque payable to his order and drawn on the X Bank. The Bank, in good faith and having carefully examined the signatures, pays money (*a*) on a cheque appearing to have been drawn by A, though his signature is forged, and (*b*) on the cheque payable to his order, though the endorsement is forged. What are the rights of A ?

(*Rajputana*)

The rights of A in case of (a)—A banker is required to make payment only on receipt of an order from his customer. In case he does it otherwise, he has no right to debit his account There is, however, one exception, and it is where forgery is due to the negligence imputable to the customer. It may be said that in this case the customer was negligent as he did not keep the cheque book safely. But the mere fact that it was stolen does not go to prove that it was kept in an unsafe place. The thieves can do wonders. It is also a matter of opinion whether merely keeping of a cheque book in an unsafe place constitutes negligence imputable to the customer or not. The customer is, however, expected to inform the bank of the theft of the cheque-book as soon as he knows of it. But as it is not clear from the facts before us that it was so, nothing can be said with certainty. We may, however,

say *that under normal circumstances. A has* got the right to refuse the payment under reference.

The rights of A in case of (b)—A banker is prevented against payment on a forged endorsement, if he makes it in good faith, and after having examined it. [Please refer to the particular section bestowing this right upon him as given in the answer to Q. 90.] It can, therefore, be said that A has no right to refuse the payment under reference.

CHAPTER XIV

BANKS

[THEIR DEFINITION—FUNCTIONS—KINDS—SOURCES—INVESTMENTS—ITEMS OF EXPENSES AND GAINS—BALANCE SHEET.]

Q. 105. Explain the relations between the banker and the customer with reference to the different types of bank accounts.

(Calcutta 1937)

A. **Relation between the banker and the customer with reference to current a/c.** The relation between the banker and the customer with reference to current a/c is that of a debtor and creditor. But sometimes the banker may grant a loan to his customer or allow him to over-draw his account. In that case, he may become a creditor, and the customer a debtor. The money deposited with a banker or given by him to the customer is not required to be held in trust. There are, however, cases where a banker is placed in the position of a trustee. Supposing, a remittance is sent to a banker with instructions to purchase shares in a certain company and the bank buys some shares, but before completing the rest of the purchase, it fails, it stands in the position of a trustee to the remitter, and, therefore, must return the entire unspent balance to him. This must, of course, be distinguished from a case where a person has got an account with a banker and asks the latter to buy certain securities out of the money which the

Primary relation is that of a debtor and creditor and vice-versa.

Trustee relationship.

former agrees to do, but fails before doing so. The agreement does not make the banker trustee for the amount in deposit. If a banker receives cheques and bills, etc., from his customer for collection, their proceeds unless something is settled between them to contrary, are not to be held in trust but to be treated as a debt.

Peculiarities :—

(i) Banker cannot return money without request, while the customer can.

(ii) Statute of limitations not applicable.

(iii) Banker to pay in a certain manner

(iv) Obligations and privileges.

This relationship has got certain peculiarities. When a banker accepts a deposit from a customer, he can repay it only on his request, and not on his own initiative as is possible in the case of an ordinary borrowing. The customer can, however, if he has borrowed money from his banker either in the form of an overdraft or cash credit or loan, return the money whenever he likes to do so. The ordinary statute of limitations can also not be applied to balances in the accounts which have remained dormant for more than three years in India and six years in England. Besides, the banker enters into an implied contract to repay the amount in the manner directed by the customer. The usual instrument employed by the customer for his directions is the cheque. If a banker pays away any amount against the directions contained therein, either through fraud misrepresentation or an error, he is held liable for it to his customer. Exception must be made in those cases where he is protected by law. The banker cannot dishonour his customer's cheques except under certain cases. He is also bound to maintain perfect secrecy as regards the accounts except on reasonable and proper occasions.

The banker is liable to make payments ordinarily only on the basis of cheques. He has no obligation to honour a domiciled bill unless and

until this obligation is expressed or implied in any way.

Relation between the banker and the customer with reference to deposit or savings bank account. In the case of a deposit or savings bank account as well the relation between the banker and the customer is that of a debtor and creditor. It may, however, be noted that in either of these cases, the relation between them cannot be reversed as is possible in the case of a current account when it is allowed to be overdrawn: Besides, the peculiarities of the relationship in the case of a current account may not be found in this case. Money cannot be withdrawn whenever desired. This can only be done under certain prescribed rules.

Relation of a debtor and creditor here as well, but conditions quite different.

Agency relationship. In all cases, when a banker makes payment on the order of his customer, whether it be in the form of a cheque or bill domiciled to him, he acts as an agent, and as such is responsible to his principal, the customer for all the acts done by him. Any breach either through error or negligence renders him liable in the same way as it renders an agent to his principal. He has, however, been given a special protection against payment on forged endorsements.

While paying, banker acts as an agent. His obligations and privileges.

We know that a banker also collects his customers' cheques, bills of exchange, promissory notes, coupons, dividend warrants, subscriptions, rents, income tax, insurance premia, and other periodical receipts. He purchases and sells on his behalf shares, stocks, debentures and bonds, etc. In all these cases, and in sundry others, his relationship with his customer is again that of

Agency relationship in certain other cases, but protection in case of collection of a crossed cheque.

an agent and principal, and as such all the rights and obligations between them are governed by rules relating to agency. There is, of course one exception, and it is in connection with the collection of a crossed cheque.

Privileges and obligations as a trustee.

Trust relationship. A banker stands in the relationship of a trustee also to his customer. An example of this was given in the very beginning of this answer. Besides, a banker receives also his customers' valuables, ornaments and jewels, documents and deeds, etc. for safe custody. When he receives these without making any charge for the service, he stands in the position of a gratuitous bailee, and incurs liability only for loss caused through gross negligence. But in case, he makes a charge for it, he stands in the position of a paid bailee and would be liable for ordinary negligence also. This is, in accordance with English law. Indian law does not make any distinction. According to it, a bailee has to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances take of his own goods of the same bulk, quality and value as the goods bailed, and in case this has been done, he is in the absence of any special contract not responsible for the loss, destruction or deterioration of the thing bailed. But this protection does not extend to a wrongful delivery. Then, sometimes, certain instruments of credit are handed to a banker not only for safe custody but also for the purpose of collecting interest, dividend or the instruments themselves when they fall due. In these cases, he can also exercise the right of his general lien on them for any debt due to him by his customer.

Special relationships. There are certain special relationships between a banker and his customer, and out of these arise special liabilities of the former in dealings with the latter. A banker must not pay the cheques of a bankrupt customer. He should not open or carry on an account with an undischarged bankrupt. On a notice of the death of a customer, the banker should stop payment of his cheques. A banker should not also make payment of a lunatic customer. He must also take care in dealings with a minor customer. Care should also be exercised in dealings with trustees, employees and agents. In dealings with an undivided joint Hindu family firm, the banker must see that the cheques are signed by the managing member, known as *karta*, and generally the eldest male member of the family, as he alone has the capacity in law to enter into contracts, etc. on behalf of the joint family firm. This is quite different from what is the case with a partnership firm, where every partner unless there is an agreement to the contrary has an equal right.

Bankrupt customer.

Deceased.

Lunatic.

Undivided joint Hindu family.

Q. 106. 'Banks deal in credit.' Explain and amplify the statement. (U. P. 1931)

A. **Introduction.** To what ever function of a bank we look, we find it nothing but a dealing in credit. It may be a purchase or sale for money or only a mutual exchange, as we shall presently see.

All transactions constitute dealing in credit.

Receipt of Deposit. When a banker receives deposit, he sells his credit for money. The customer is allowed to use the banker's credit—*viz.*, the cheque he pays in, as he knows that he receives a right to use cheques. In a number of

It is a sale of credit.

Exchange of mutual credit.

cases, the customer is also allowed to withdraw even without his having deposited money in advance. This is because he has credit. The banker in such a case, relying upon the credit of the customer allows him to use his credit instead. This is nothing but exchange of mutual credit. The customer here exchanges bank's credit for his own, for he knows that the former has a greater range of acceptability than the latter. A considerable part of the deposits of modern banks arise in this way.

A purchase or exchange of Credit.

Discounting. Bankers discount bills. Herein they purchase commercial credit for ready money. Sometimes they allow the holder to draw cheques. This is again merely exchange of mutual credit. If and when they rediscount them with the central bank, they again deal in credit.

Again, a purchase of credit or mutual exchange.

Advances. When a banker advances money he does so because he has confidence in the debtor's integrity. He purchases his credit for ready money. If he pays actually in cash ; or else he exchanges it for his own in case he allows him to withdraw whenever he likes.

Mutual exchange of credit.

Bank acceptances. Sometimes customers are allowed to draw bills on banks, which accept them. Bank acceptances can be more easily discounted in money markets than mercantile acceptances. The drawers get money by discounting such bills, and banks in this way, by exchanging mutually their own credit with that of their customers, make the funds available to them.

Bank credit is sold.

Issue of Drafts etc. They also issue drafts, letters of credit, etc., for the transference of money. This is also dealing in credit. The

customer relying upon the credit of the bank gives it money, and the bank's credit is honoured everywhere. These drafts and letters may also be foreign.

Investment. Banks invest money in Government and certain other kinds of securities. These are nothing but credit instruments, and when a bank purchases them, it deals in credit. Most of the funds of our banks are investments in this way.

Purchase of public credit.

Q. 107. Discuss the principal functions of a banker. Point out in this connection the relative importance of each. (*U. P. 1932*)

A. **Principal functions.** The principal functions of a banker are five :—(1) to receive deposits of money ; (2) to discount bills of exchange and promissory notes ; (3) to grant loans ; (4) to act as agents for customers for collection of dividends, bills, cheques, etc., and for payment of annuities, premiums, etc. : (5) to transfer money from one place to another.

Five important functions.

Sometimes back, issue of notes was a very important function. But in most countries it is now restricted to central banks.

Deposits. The bank receives large sums of money by way of deposits of different kinds, the most important of them being current and fixed. When money is received on current account, the depositor is allowed to withdraw whole or part whenever he likes. In case, however, it is received on fixed deposit account, withdrawal is not allowed before the expiry of a fixed period. From this, it appears that money received on fixed deposit accounts is more important from a banker's point of view than money received

Current.

Fixed.

Relative importance of each.

on current accounts as the former can be utilised by a banker for a definite period while the latter cannot be used. *But in fact this is not so. Deposits on current accounts are also very important, and perhaps most important. They form* a considerable portion of the total deposits, and the banker has learnt by experience that demand for their withdrawal at any one time is often very much limited—so much so that it can be met out of daily receipts. Even then he keeps some portion of it always in hand with a view to meet emergency. The rest, it supplies to others. This provides for the main source of its income.

Demands for withdrawal from current accounts can be met out of daily receipts.

Discounting. The banks discount bills of exchange and promissory notes. When they do so they buy a right due at a fixed future time, and give in return money or a right to demand it immediately. This business is very important. From banker's point of view, it is important because it ensures stability of value, certainty of payment on due date, employment of funds for a definite period, and possibility of conversion into cash at pleasure by rediscounting the bills with the central bank. From merchant's point of view, it is important because it enables him to replenish his stock immediately after the sale.

It provides stability of value, certainty of payment on due date, employment of funds for a definite period, and possibility of conversion.

Granting of loans. This may take several forms—overdrafts, loans on promissory notes, personal loans, and cash credits. The time for which such loans are granted is usually short—ranging from three to six months. The loans so obtained by the customers are usually not taken immediately but are left with the bank in their current accounts to be subsequently withdrawn as and when required. They swell the deposits

Its various forms.

Loans obtained are not withdrawn immediately.

of the bank—so much so that 90% of the deposits in Great Britain are such deposits. In fact, the enormous amount that the banks lend is made possible only because they know that most of them will not be withdrawn in cash.

Acting as agents for customers. Bankers act as agents for their customers for collection of dividends, bills, cheques etc., and for payment of annuities, premiums, etc. These are important inasmuch as they increase the banker's deposit. When dividends, bill, and cheques are collected, deposits increase, while, on the other hand, payment is made possible only by transference of amount from one account into another.

Creation of deposit in this way also.

Transferring money from one place to another. The business of transferring money from one place to another is also important. Bankers earn profit here for doing practically nothing. They only advise their branches and correspondents of the transfers, and accounts are settled mutually. This also increases deposits. Payees do not generally withdraw money in cash. Again, they can be utilised at least for the period of transmission.

Its nature.

Creation of deposits.

Q. 108. What are the various ways in which a bank deposits arise ? Do they represent actual cash deposited by the customers ? How does a bank lend more than the actual cash deposited with it ? *(U. P. 1940)*

A. **A bank's deposits arise in different ways.** The first and most important of these is deposit by receipt of cash. Those who have surplus money with them keep it with banks. If they think that they would need it in a near

Cash deposits.

(i) Current accounts.

(ii) Fixed deposits

future, they deposit in what is known as current account. If, however, they feel that they would not require it for a definite period, they keep it in fixed deposit account.

Loan deposits.

Withdrawal by cheques and its effects.

Bank deposits also arise out of loans. When anybody takes a loan, mostly he gets it on the understanding that he is not to receive it in cash. The whole money is placed to the credit of his account and he issues cheques to the maximum extent for sums he requires. These cheques in their turn pass through the clearing house system, and accounts are settled simply by book entries.

Deposits arise out of discounting business.

They also arise when bills are discounted. The amount of the bill discounted is usually placed to the credit of the customer. This swells the bank's deposits. They are very important in Western countries.

Deposits arising out of collection business.

Banks also receive deposits when they undertake to collect bills, cheques, and such other documents for their customers. They credit the customer's account with the proceeds of these documents. Insurance companies empower banks to receive premium on their behalf. Every receipt of the same increases bank deposit to that extent. In some cases, they are under obligation to keep some balance to their credit.

Arising out of remittance business

When people want to transfer money from one place to another, they deposit it with banks. For every bank draft or letter of credit issued, the bank's deposit increases. The transferrer deposits money in the first instance. Again, the transferee also usually does not draw it in cash.

He leaves it with the bank to be drawn as and when required.

Conclusion. From the above it is clear that all deposits do not represent actual cash deposited by customers. In fact, in Western countries only 10% of the deposits represent actual cash received, 90% of them arise only out of book entries. This percentage differs from place to place. The larger the practice to use cheques the larger is the percentage of deposits arising out of book entries.

All deposits do not represent actual cash deposited.

Use of cheques increases deposits.

Banks lend more than what they possess. A bank is enabled to lend more—several times more—than the actual money in hand as it knows that ready cash will not be withdrawn in many cases. Let us take an illustration. Suppose a customer has deposited Rs. 10,000 with a bank in actual cash. The bank, knowing that all the cash will not be demanded at one time or whatever demand is made will be more than offset by new deposits, can utilise Rs. 10,000 cash for creating more deposits. It leaves, say, Rs. 1,000 for meeting the demand in connection with this particular deposit, and the rest Rs. 9,000, it utilises for giving loans and advances and discounting bills. It does this not only to the extent of Rs. 9,000 but say, to the extent of Rs. 40,000 because even for the advances made and bills discounted, it is not required to pay in cash. Instead, customer's accounts are credited. The bank's liability thus increases to Rs. 50,000, while it has got cash in hand only to the extent of Rs. 10,000. The balance is represented on the assets side by the terms 'bills' and 'loans and advances'.

Illustration.

Q. 109. Show the relation between a bank's loans and its deposits. How far is a deposit created against a loan similar to issue of notes?
(U. P. 1936)

Capacity to grant loans dependent upon cash in hand.

A. **Relation between a Bank's loans and its deposits.** There is a very close relation between a bank's loans and its deposits. Firstly, its capacity to grant loans is determined by the actual cash deposited with it. The ratio between the amount of cash which it holds and the amount of loan which it can advance depends upon various factors. The most important of these is the habit of the people. If they are accustomed to make payment by cheques, difference between the cash in hand and the amount lent may be very great. While on the other hand, if they usually make payment in actual cash, it is very limited. It payments are made by cheques, the bank is not required to give cash for all of them. A considerable number is settled through the clearing house. As English people use cheques for almost all payments, loaning capacity of English banks is about 10 times of the cash deposit in their hands. As a remarkable contrast to this, we have the banks of our own country. Here most of the payments are made in cash and hence the banks have always to keep a high percentage of reserve. Thus, they generally do not advance more than 4 or 5 times of what they have in cash with them. Again, it also depends upon the availability of assets capable of being realised as soon as there is a demand for cash. In Western countries bills are available to a very great extent. London is a world market for them, and hence a considerable part of the assets of the London banks comprises of these. They can be

Actual percentage required depends upon (i) habit of using cheques.

(ii) availability of assets capable of being realised on demand.

rediscounted with the central bank. In our country there is a shortage of the supply of bills due to certain obvious reasons. Then, political and economic conditions also determine the ratio. During the period of distrust, a greater percentage is required to be kept in cash. (iii) political and economic conditions.

Next, amount of deposits depends upon the loan and discount policy of the banks. In case they charge a low rate of interest and are liberal in making advances and discounting bills, deposits increase. They usually grant credit on the understanding that the amount is not to be withdrawn in cash. What is done is that it is placed to the credit of the customer who issues cheques whenever he has to make payments. These cheques pass through clearing house, and as we have seen are offset there. Indian banks are not liberal in granting loans. They demand securities for all the loans, and as these are not available, the amount that they lend is very small. In U. K. and U. S. A. much of the credit is granted against bills. A considerable portion is also granted against personal security. In our country, bills are not available and banks do not grant credit on personal security. As a result of this policy, their deposits are also very limited.

Amount of deposits depends upon the loan and discount policy.

Loaning policy in India and its effects upon deposits.

Q. 110. Describe the various methods in which a banker employs his resources. (U. P. 1932)

A. **Employment of resources require use of brain.** Success of banking lies in the way a banker employs his resources. He may at any time be asked to pay in cash. This necessitates his being always in liquid position. But on the other hand, he must also earn money to distri-

His two-fold obligations.

bute dividends. Thus, he has to perform a dual task which is really difficult, if not impossible.

Essentials

He can, however, do it, if he allocates his funds over diversified investments and loans, besides maintaining a cash reserve, in such a way as to keep him always into repletion of funds. In order to gain this, he has to keep in mind certain well-known principles of banking. Firstly, he must marshall his securities in such a way that they fall due in a steady succession and enable him to tide over any occasional difficulty.

(i) Maturity in steady succession.

Then, he must not keep too many eggs in one basket. If he loans out his money to one customer or to a particular class of customers, it is possible that he may lose the whole of it, or may not be at least able to realise it for sometime. In case, however, his investments are distributed over a wide field, there is no such danger.

(ii) Investment over diversified fields.

Again, he must not lodge up his large sums for long periods in real estates. There are not easily realizable and may be useless for him when he needs funds at his command. He should generally advance funds on the security of bills. Government paper, Railway Debentures and such other securities capable of being easily realisable may also be held. He must, however, keep always ample cash in hand.

(iii) Long-term loans on the security of real estates not suitable.

How much case is ample is again a question difficult to answer. The reserve should be based upon a number of considerations. These vary in the case of banks belonging to different countries—nay in the caseof each bank of the same country and also in the case of the same bank from time to time.

Determination of cash reserve.

We have, in short, laid down some of the general principles which guide the bankers to

employ their resources. Now, we shall see how they actually employ them.

Conclusion in short.

Two forms of uses. Generally, the banker puts his resources to two forms of uses, *viz.*, the *profitable and the non-profitable. First of all* he has to provide for buildings, furniture and fittings etc. These must suit the conveniences of the customers and the requirements of the banking business, *e. g.*, the building must be so carefully constructed as to hold money without fear of burglary and fire, etc. They cost a huge amount. All these provisions are collectively spoken of as dead stock.

Profitable and non-profitable uses.

(i) Dead stock.

Another non-profitable use of a bank's resources is found in the maintenance of cash reserve. Its necessity has been already explained. In fact, this forms the first line of defence in case of a run upon the bank. It wards off bankruptcy.

(ii) Cash reserve (first line of defence).

The above non-profitable uses do not really comprise banking business. In fact, a banker must use his resources profitably in order to justify his existence. This, then, brings us to his employment of the remaining of the resources in other channels. These are very many and differ in character.

Profitable uses of resources comprise banking business.

First of all, we have what is known as money lent on short notice. This is lent to bill-brokers, stock exchange brokers, and discount houses. These have to deposit high class securities to cover the loans. The rate of interest charged on this loan is very low as it can be called within twenty-four hours. But the yield is not insignificant. It may appear at the first instance that this money cannot be of much use to the borro-

Money lent on short notice.

Yield considerable.

wers as they cannot use it with certainty for the fear of being called away to pay it up all at once. But this is not true. A shrewd operator might earn a good deal even in the course of a single day's use of money. It is also very important from banker's point of view. Coupled with a good yield, it also provides him as a second line of defence, for the securities lodged with him can be easily realised in cases of default. There is, however, at certain times, felt considerable difficulty in their realisation, and hence they cannot do away with the necessity of maintaining adequate cash reserves.

Useful to borrowers.

Provides a second line of defence to bankers.

(ii) Long period loans.

Then, the bank also gives loans and advances for long periods too. Generally, these long periods range from three months to nine months. Such loans may take the form of either overdrafts or loans on promissory notes, or personal loans or cash credits. It should, however, be always borne in mind by a banker while making these advances that he has to be well on guard lest he might lose the money.

Different forms.

Safety, main consideration.

(iii) Discounting.

The third form of employment is in the shape of discounting bills of exchange. The points in favour of discounting are many. Firstly, the value of the bills is stable. Then, there is a certainty of payment on due date. Again, funds can be distributed in such a manner as to fall due successively. Finally, they are convertible at pleasure, as they can be rediscounted at the central bank.

Its superiority over other forms.

(iv) Bank acceptances, their nature

Bankers also accept bills on behalf of their customers. While doing so they are not required to make payment immediately. In fact, they get the money from the customers before such

bills fall due. Again, there is no risk to them, as they do it only after throughly ascertaining the customer's standing and resources. Then, they hold securities which they can realise, if necessary.

Finally, bankers purchase securities in the open market. These are gilt-edged or such others as are near to gilt-edged. While investing money in this way, two points should never be lost sight of. Firstly, that they must be easily saleable in the market, and secondly, that they must be stable in value. Speculative securities are not good for a bank.

(v) Investment in securities.

They must be easily saleable and stable in value.

Q. 111. Describe the different methods in which a banker employs his resources. What do you consider as the liquid resources of a bank. *(U. P. 1941)*

A. This question can be solved with the help of the answer to the previous question.

Q. 112. Discuss the various methods employed by banks for the investment of their funds.

What considerations shouldg uide them in the investment of their available funds ? *(U. P. 1936)*

A. For answer of this question please consult answer to Q. 110.

Q. 113. Explain discounting of bills.

What precautions should a banker take in discounting bills of exchange ?

(U. P. 1938)

A. **Discounting of bills.** Discounting of bills by banks means paying their present worth. In discounting, a banker charges the profit at the time of advance. In many cases the net amount of the bill is also left with him. So, in such

Paying their present worth.

Profit charges in advance.

Net amount left with the bank to be drawn by cheques.

cases, he earns even without paying anything. Cheques are, later on, drawn upon him. These, however, pass through the usual course, and are either credited to the holder's account or offset through the clearing house system.

Precautions necessary. But there is also a considerable risk in this kind of business. The bank, therefore, must take all possible precautions before discounting a bill. Firstly, it must ascertain as to its genuineness. Besides the trade bills that arise out of trade transactions, there are also drawn accommodation bills. It is really very difficult to distinguish between them. But the banker can find out something provided he exercises his minute judgment. An accommodation bill does not represent any tangible form of goods, and in case of dishonour, may even prove a loss to the banker. A genuine bill is, on the other hand, backed by goods and thus the chances of loss are minimised. The acceptor has, after all, a real strength to honour it. There are bills of other kinds too, but in their case also the risk is not so great.

Distinction between trade bills and accommodation bills.

Its should be complete in every way.

Next, the banker should see that the bill is complete in every way. It must be drawn, accepted, and endorsed in the regular and proper manner. He must also satisfy himself to the effect that the title of the holder is not defective in any way. The business career of the various parties to a bill should carefully be scrutinized. A thorough enquiry will reveal if there is anything wrong.

Business career of the parties to it.

The bill portfolio of a bank should be evenly distributed both from the point of view of trade and period. Even distribution from the point

of view of trade means distribution of the whole business over a number of trades. If too many bills of a particular trade are discounted, in case there is a setback to this trade, the banker is likely to lose a considerable amount. While if bills of several trades have been discounted, setback to a particular trade will affect the bill relating to only that trade. Then, all the bills should not fall due at one time. They should be so discounted that they may fall due in successive order. He can make an arrangement which will enable him to tide over any occasional difficulty.

Even distribution between (i) different trades (ii) different periods of maturity.

Q. 114. Explain discounting of bills. In discounting bills for a customer what are the points to be considered? *(U. P. 1941)*

A. An answer to this question can be given with the help of the answer to the last question.

Q. 115. Explain clearly the discounting and rediscounting operations of banks. Why is the discounting of bills so popular with banks? *(U. P. 1939).*

A. **Discounting operations.** Herein all that is contained in the first para of the answer to Q. 113, has to be repeated.

Obtaining of funds by banks from the central bank.

Rediscounting operations. Rediscounting operations of banks, on the other hand, mean obtaining by them present worth of the bills from the central bank. The central bank does not usually discount the bills of the merchants directly. It generally insists upon the signature of at least one bank. So, bills are normally discounted with the banks. These banks, when they are short of funds, get their bills rediscoun-

In discounting bank obtains a right to sell and negotiate.

ted with the central bank. When a bill is discounted with a bank, it obtains all the rights upon it. Discounting is different from pledge inasmuch as under the former, the bank acquires the right to sell or negotiate the bill, while under the latter, it cannot do so without giving prior notice.

Causes of the popularity of discounting. From the above discussion it must have become clear why discounting is so popular with banks.

Profit in advance and often without parting with money.

First of all, we have seen that they get profit in advance and in many cases even without being called to hand over the net amount. Again, they can be rediscounted with the central bank if there is shortage of funds. This is very important. Banks may be called upon to meet very heavy demands at any time. If they are unable to meet them out of their cash resources, they must make arrangement to liquidate other assets. They can call back the money lent on call or short notice, but there may arise some difficulty in it. Loans to customers cannot at all be called up. A call for them arouses unnecessary suspicion. In fact, nothing should be done at such occasions to alleviate public confidence. Securities are also not easily saleable under the circumstances. Rediscounting, however, provides a good source for getting money.

Rediscounting facilities.

Issue of currency against bills

Central banks have power to issue currency against bills and they are always prepared to help other banks by rediscounting their bills.

Stability of value

Then, there is stability of value of the bills. Securities may fall in value. In their case, however, the banks are assured of getting the face value.

Certainty of payment on maturity.

There is also certainty of their payment on due date. Moneys lent on other accounts

may not be repaid when they are due. But bills must be honoured on their due date. Even if the acceptor fails to honour, there is the drawer, and in case of his failure too any of the endorsers may be called upon to make the payment. Bills have different tenures to run, and banks can easily strengthen their cash reserves by so arranging their stock of bills that they may fall conveniently due, to meet all possible periodic drains.

Distribution according to period.

Q. 116. What part does the discounting of bills of exchange play in the financing of commerce and industry ? *(U. P. 1932)*

A. **Introduction.** Discounting of bills plays a very important part in the financing of commerce and industry.

It plays an important part. The present day commerce is carried on mostly what is known as the credit system. The sellers have to sell goods on credit, and as soon as they have sold them, they must replenish their stock. No doubt, they in their turn also purchase on credit. But they keep stock with them, and in many cases they are required to make payment of the purchase price of the goods before the credit granted to their purchasers terminates. Under the circumstances, if they have bills with them and in case these are discounted they obtain the necessary funds. This, therefore, enables the merchants to replenish their stock. This sort of advantage is derived by all classes of merchants from wholesalers to retailors including all intermediaries. In fact, movement of all merchandise is much facilitated by this procedure. This is not only true of manufactured goods, but also of

Present-day trade is carried on credit basis.

Bills discounted and stock replenished with the proceeds.

Movement of merchandise is much facilitated.

the agricultural goods. In countries, where use of bills is very common and they can be easily discounted, trade has highly developed. But, unfortunately in our own country it is not so. We have a very limited use of bills. Hundis, which are to all intents and purposes equivalent to bills, are also not very popular these days. Again, there is difficulty in discounting whatever bills or hundis we have, due to various shortcomings of our banking system. It is hoped that these will be gradually removed by the Reserve Bank of India.

Limited use of bills in India.

Difficulty in discounting and rediscounting.

Industries are also financed in this way. Firstly, manufacturers have to grant credit to the wholesalers, and when they have sold the finished stock, they must replenish it. This, they do by discounting bills accepted by the wholesalers. Again, they get credit from the suppliers of raw materials also as these in their turn can arrange to be financed by discounting the bills accepted by the manufacturers. Discounting can, however, provide funds for only short periods or, say, a part of the circulating capital of the industries. This also finances agricultural industry. In America, a kind of bill known as anticipatory bills is commonly used for this purpose. It is drawn on the basis of prospective property of a crop. In short, it is mortgaged by means of such a bill which is primarily intended to procure funds to meet the current outlay. In India also, use of such bills has been recommended. They will surely go a long way to help the agriculturists.

Financing of industries—(i) Manufactures.

(ii) Agriculture.

Anticipatory bills.

Q. 117. In what different forms can a businessman get credit from a bank? Explain these

forms, pointing out the difference between them. (*U. P. 1938*)

A. **Different forms.** There are various forms in which a businessman can get credit from a bank. First of all, we have overdraft. In case, he has a current account with the bank, he may approach it to allow to draw beyond his credit balance. In fact, this is the literal meaning of overdraft. It is designed to accommodate well-known customers in excess of their deposits. The agreement, as to the extent to which a customer needs such accommodation is made at the outset. This accommodation is granted on the strength of some security deposited with the bank to cover the overdraft. The interest is charged on the daily balance standing to the debit of the customer, calculations being made half-yearly. The banker, under such circumstances, enjoys a general lien upon securities deposited with him and in cases of default recovers money by effecting a sale. This business is, however, not done to any considerable extent in India.

Overdraft.

Then, there is loan on promissory notes. These serve as securities. If the borrower is of good standing, a promissory note bearing his signature alone is quite sufficient. The general practice is, however, to demand a joint and several promissory note. In this case, the bank has the right to demand money from any of the signatories severally or from all or any number of them combined. Because of this characteristic of the kind of loans, it is very safe. Interest is charged on such loans on full amount from the date loan is granted till the date it is paid back. Overdraft is from this point of view, preferable

Loan on promissory notes.

Comparison of overdraft with loan.

to this form of loan or others which will be discussed hereafter. *But in order to counter-balance the difference, banks generally charge a higher* rate of interest on overdrafts than on loans of other kinds.

Personal loans.

Banks also grant personal loans to their customers on the strength of their personal character, and record of their business success. A bank may possess very few customers of this type. To refuse them credit on their personal security may be harmful to the bank. It may cause their displeasure or resentment which in its turn may result in losing their patronage.

Cash credit.

There is also cash credit system. It has played a very important part in the commercial development of Scotland. There it is available to all, poor or rich, to youngmen commencing business and to established businessmen, industrialists and agriculturists. It is created when bank agrees on receiving sufficient guarantee to open or create credit to a certain amount in favour of respectable or trust-worthy persons. Everyman in business needs cash, and hence he must keep some of it always in hand. But money in hand is idle money. If bank is ready to supply businessman with cash whenever he needs it, he does not require idle money to be kept with him. It is employed to more profitable uses. In India also, cash credit system is becoming very popular. Bankers create credit against granaries or other stocks of goods.

Its advantage.

Loans on the basis of Collateral Securities.

Loans can also be obtained on the basis of collateral securities. The bulk of the loans is advanced in this form. In this case, loans are made by banks on the pledge of property or title

to the property which can be sold by the bank if the loan is not paid back. Here, the bank does rely the promise but over and above it keeps in its possession actual property or title to it which it has the right to sell in the event of default. In this connection, the nature of property is very important, Mortgage of real estate is the worst form of security. It cannot be easily sold Agent, its value is no testable. Gilt-edged securities are very safe.

Discounting of bills.

Its advantages.

Beside the above forms of loans, we have also got discounting of bills. This is very popular with banks. Businessmen also have no difficulty. In fact, it is more convenient for them as well. They sell goods on credit and draw for it a bill of exchange. This, they can discount at any time by paying a small amount by way of discount charges. Banks also prefer this kind of business. They get here the right to negotiate it. In other cases, the right of sale can be exercised only in case of a default. Banks can rediscount bills at any time with the central bank. A bill is stable in value. There is also a certainty of its payment on due date. Again, a banker can distribute its funds over bills of different tenures according as he thinks proper.

Q. 118. Distinguish between cash credit, overdraft and loan, explaining their respective merits from the points of view of bankers and borrowers. *(U. P. 1940)*

(This question can be answered with the help of the answer to Q. 117.)

Q. 119. What is credit ? Discuss the limitations on the power of banks to create credit. *(U. P. 1942)*

A. For an answer to the first part of the question, please consult this heading to the answer to Q. 84.

Deposits can be created both by banks and their customers.

Bank's power to create deposits is limited.

Limitations on the power of banks to create credit. When a customer is temporarily short of funds, he approaches the banker for a loan, overdraft, cash credit or discounting of bills. In all these cases, the latter knows that the money is not required for hoarding but for making payments. He, therefore, grants accommodation usually on the understanding that actual cash will not be immediately withdrawn, but the borrower shall draw cheques upon him whenever he wants to make payments. This right to draw cheques is also common to deposits made in cash by the customers. Hence, we may say deposits may be created either by the customer or by the banker. It is created by the customer, when he deposits actual cash, and it is created by the banker when he grants loans. But the banker's power to create deposits is limited by the cash reserve that he holds. We may, therefore, repeat what J. M. Keynes said that loans are the children of deposits and deposits are the children of loans. But this is not thoroughly understood by many, and hence the belief that credit is the mere creation of the bank clerk's pen, and that but for the malevolence of the wicked banker enough of it could be created to remove poverty and banish toil from the world. They do not seem to imagine 'why the banker should be so concerned to reduce the volume of the material in which he trades and from which he earns his living', if he has the power they think he has.

The limitations, therefore, on the power of

banks to create credit arise out of the volume of cash deposits. In fact, they have to maintain a minimum percentage of cash reserves to credit. This percentage is, of course, dependent upon various factors. (1) In some countries, the legislators have fixed certain proportions to be observed by the banks. (2) It also depends upon the percentage kept generally. If one bank in a locality keeps a higher percentage, other banks in that locality must keep the same to win confidence of the people (3) The size of the cash reserve of a particular bank will also depend upon the average size of the deposits of each customer. If cheque habit is sufficiently developed and payments are not generally made in cash the amount in reserve may be smaller than if otherwise is the case. (5) If clearing system is well-developed, most of the cheques drawn on a bank are counter-balanced by those received by it but drawn another banks, and hence there is, very often, not the need felt for finding out actual cash for their repayment. (6) In case, banking habit of the people of a place is sufficiently developed and they are not used to hoarding. there is a constant inflow and outflow of funds into, and from, the banks which means that they can carry on with smaller cash reserves than is possible if otherwise is the case. (7) If the customers of a bank belong to such classes as bill-brokers or discounting firms whose accounts are of a fluctuating nature, a larger cash reserve would be required to meet the heavy withdrawals at times when there is a greater need of money to them due to increase in business. (8) If the investments of a bank are such as can be liquidated easily, a smaller cash reserve

Limit is put by the volume of cash deposits.

Actual cash reserves depend upon various factors.

would be necessary as they would be realised whenever required. (9) Finally, if banks are situated in a commercial area, they are required to keep a much larger cash reserve than if they are situated in an agricultural area, for payments in the former are much heavier in proportion to the average balance than in the latter.

Other limitations:- Availability of marketable securities. Only current transactions are financed. Short term credits. Productive credit. Character and capacity of the borrower.

Though volume of cash deposits is the main limitation to the creation of credit, there are others as well. For instance, availability of marketable securities, as bankers' loans ought to be usually secured. Then, a banker finances only the current transactions of the community. He is not required to coin all kinds of unmarketable wealth into money. Nor is he expected to coin credit for future needs. Besides, he creates only short-term credits. Continued renewal of loans is also undesirable from the point of view of safety. A banker also enquires into the object of the loan. Creation of credit for consumption purposes should always be discouraged. Finally over and above all these, the character of the borrower and his capacity to repay, are also required to be taken into account.

Q. 120. The best bank manager is one who can distinguish between a discount and a mortgage and reconcile profit earning with safety! Explain the statement. *(U. P. 1940)*

Banker's aim.

A. **Mortgages considered.** When banks use other's money, they use it in such a way as to earn profit and at the same time keep it safe. Keeping money safe does not mean only its recovery but recovery at the required time and without any loss of value. When money is advanced on the basis of securities, it is a sort of

mortgage. But a mortgage is not good enough. The bank has the right on the property mortgaged or title deeds pledged with it only to the extent of loan, and that too is very much limited. For instance, it cannot sell it whenever it likes. In fact, the real owner of the property is the person to whom it belonged, *i. e.*, the borrower who mortgaged it with the bank—and not the bank. If it wants to sell the property, it has first of all, to inform the borrower and gave him some time to get it released on paying the debt. It is only when the term of the notice expires that it can sell it. The value of the security or property may fall. If it is so, the bank has to face another difficulty. It is obvious from this discussion that mortgages are not good from a banker's point of view. In India, there is a special difficulty. It is that equitable mortgages are not allowed in all towns. They are allowed only in such places as Calcutta, Bombay and Madras. This makes the sale of the property difficult.

Mortgage is not good enough.

Limited right.

A notice of sale is necessary.

Not stable in value.

Equitable mortgages not allowed every-where in India.

Discounting. Discounting is, however, very advantageous. Banks acquire a right of ownership over the bills discounted with them. They can deal with them in any way they like. They have the right to sell, negotiate and rediscount them. It is this right of rediscounting that makes this kind of business so very popular. When a bank needs funds, it rediscounts its bill portfolio with the central bank. It is thus assured of the recovery of money at any time he likes. A bill is, again, stable in value. The amount receivable at the expiry is fixed for ever, and that receivable at any time before the expiry, on rediscounting, fluctuates within a fixed limit

Right of ownership over the bills discounted.

Rediscounting.

Stable in value.

according to the period it has to run. In short, *there is no possibility of loss due to fall in value in the case of a bill, as there is in case of a mortgage.* A bill is also sure to be paid on the due date, while a debt on the basis of a mortgage may not be paid on the expiry of the term.

A proper arrangement.

Then, a bank can so arrange its bill portfolio as to make money available at all times or at particular times of drains.

Conclusion.

A bank manager, conscious of the above facts, will naturally distinguish between a discount and a mortgage. He will so arrange his advances as to make them earn sufficiently, as well as keep safe.

Q. 121. What are the various forms of security against which advances may be made by a banker? Discuss the merits of each form of security.

(*U. P. 1943*)

A. **Various forms of security against which advances can be made by a banker.**

Personal security of the borrower.

First of all, there is the personal security of the borrower. In many cases, when the customer is a man of unimpeachable reputation and sound financial position he is granted a loan or allowed an overdraft on personal security. In such a case, the banker depends entirely on his integrity, strength of character, prompt and business-like dealings. But in order to safeguard his position the banker may also take the signatures of one or two independent sureties or guarantors on the promissory notes executed by such a person.

Others may also stand as sureties.

In case of default the principal debtor is, however, the person to whom the loan is granted. The banker can realise his claims from the

surety or the guarantor only in case they remain unpaid from the property of the debtor.

Borrowers are generally required to deposit collaterals for loans advanced to them. Collaterals signify some tangible property or right of ownership to it or documents of value. Collateral means additional, and such securities are known by this name because they stand by the side of the personal security of the borrower. In fact, they can be disposed off only in the event of his failure to repay the loans promptly.

Sometimes, collaterals also required.

Character of collaterals.

Collateral securities usually offered to a banker may be grouped under the heads of (1) Stock Exchange Securities, (2) Negotiable Instruments, (3) Goods or Documents of Title to Goods, (4) Life Policies, and (5) Immovable Property.

Their grouping.

Merits of each form of security. Personal security is, of course, the best form of security. If the borrower is capable of making the payment and honest, he is sure to refund the money. If, however, it is backed by the guarantee of somebody else or some collateral security, it is so much the better.

Personal security.

If the borrower does not make the payment, the guarantor can be asked to do it, and he will, of course, make the payment. He has, however, got the right to realise the money from the principal debtor, when he has once made the payment.

Sureties.

Stock Exchange Securities are easily and quickly marketable, and hence provide a good means of recovering the debt in case the principal debtor fails to honour his promise. Besides, their market value can be easily ascertained. Their value also does not fluctuate violently. Their

Quickly and easily marketable

Value easily ascertainable.

Title clear

title is also clear and hence they are transferable without much difficulty. In the case of negotiable securities, the banker, if he takes them *bona-fide* and for value, also acquires a title against all the world to hold them until the obligation they were given to cover is discharged. In times of need, stock exchange securities can be pledged as well with the central bank without much difficulty for advances from it.

Re pledge possible.

Good title; Fixed value; Re-pledge possible; Automatic maturity

Negotiable instruments give better title to the banker, if obtained in good faith. Their value is also fixed. Besides, they can also be re-pledged. Finally, they get matured automatically at the end of the period of maturity.

Tangible securities, value does not fluctuate violently; saleable; Recovery of money easy; value easily ascertainable

Goods or documents of title to goods form tangible securities. Their value also does not fluctuate widely. They can also be sold very easily. Besides, advances made on their basis are likely to be paid within a short period as they are sold at the earliest opportunity coupled with sufficient profits. Their value as well can be easily determined.

Value easily determinable and goes on increasing

If there has been no misrepresentation, or inaccurate information at the time of the proposal life policies form a good security against advances on the basis of the actual surrender value which is easily ascertainable, as on the back of each life policy itself, the mode of the determination of surrender value is given. It can also be found out by reference to the Insurance company. The value of a life policy goes on increasing as the time lapses, provided of course premiums are being paid regularly, and this is perhaps an extra advantage which attaches to it. Where a policy has been deposited even without a me-

Good title even in case of bankruptcy.

morandum, and the depositor becomes bankrupt, the trustee in bankruptcy cannot claim the policy without satisfying the claim of the banker. A life policy also just like a negotiable instrument automatically matures on the borrower's attaining a certain age or in the event of his death. If a policy has been assigned and notice given to the Insurance company, it provides a complete security. There is no difficulty in proving the title. It can also be assigned by a banker to a third party as security for an advance.

Automatic maturity.

Assigned policy better

Can be re-assigned.

When immovable property is offered for security, it is required to be mortgaged, and at such times, the deeds must be examined by a competent authority with a view to ascertain their genuineness and correctness. Care should also be exercised in valuing the property and as far as possible, experts should be appointed for this purpose. Insurance must also be effected. In fact, immovable property has got no merit to be accepted as cover against advances, but as there are some customers who cannot offer any other thing, it has to be accepted.

Careful examination and correct valuation necessary.

Insurance desireable.

No merits.

Q. 122. What are the securities on which a bank gives loans? Compare their advantages and disadvantages from the point of view of the bank and its customers. (*Allahabad, 1942*)

A. This question can be solved with the help of the answer to the last question. Disadvantages of each kinds of securities are, however, given below.

Disadvantages of various kinds of securities. In the case of a partly paid share or debenture, the banker may be called upon to pay

Liability for uncalled up money.

the uncalled portion, as a failure to do the same usually leads to its forfeiture. Next, certain joint stock companies insert a clause in their Articles to the effect that they will have a first and paramount lien on their own shares for any debt due by their customers who happen to be their shareholders also. In such cases, a banker may find his right valueless if he finds at the time of their sale that there is a debt owed by his customer to the issuing company as well. Finally, if the securities are non-negotiable, there is much inconvenience at the time of transfer. Then, the banker's title to them is the same as that of the transferrer, and it is possible that it may turn out to be defective.

Banker's right may turn out to be valueless.

Difficulty of transfer and possibility of title turning out defective.

A negotiable instrument has only one defect, and it is that it entails upon the banker the duty to realise its value on maturity.

A negotiable instrument entails the liability of collection.

Goods are liable to deterioration and damage. Their value is also subject to daily fluctuations, though not widely. In certain cases, it requires an expert knowledge to make a correct estimate of quality, and hence there are greater chances of fraud as well. Besides, some goods require a huge space for storage. There is also a greater possibility of theft in the case of goods pledged. Then, goods being required by the borrowers in small lots according as they are sold by them, the banker is put to much inconvenience in giving delivery and keeping a record. There is a danger of mistake in releases as well. In the case of documents of title to goods, however, there is only the danger of forgery. Finally, goods and documents of title to goods are very unpopular in India because of certain special

Goods liable to damage and deterioration; value fluctuating; difficulty in examining quality; storage difficulty; possibility of theft; difficulty in giving releases.

Both are unpopular in India.

reasons. First of all, there are no licensed warehouses worth mentioning in the country. Secondly, there is a lack of suitable grading in the case of many commodities. In others, it is not strictly adhered to. Lastly, there is an absence of organised markets for certain staple commodities in various places and hence the difficulty in ascertaining their value.

Absence of licensed warehouses, suitable grading, and organised markets.

The validity of a life policy may be questioned at the time of payment, in case it turns out that the assured had not disclosed all the material facts in the proposed forms. In case, age of the assured has not been admitted, it might become extremely difficult for the banker to prove it in the event of the former's death. Cases of suicide and death by the hands of justice are also not usually covered by an insurance policy. In case, a policy is taken out by the assured to provide for his wife and children, it may not be good for the reputation of the banker to put his claims against the widow and orphans. Then, the value of a policy increases only by the continued payment of the premia. If they are not paid by the assured, the banker might be required to make the payment himself. Besides, if the policy has been taken by a third person, it may become void in the absence of an insurable interest. Finally, if the policy has not been taken possession of, it is possible that a subsequent mortgagee may obtain a prior right of assignment to the banker giving earlier notice and obtaining its possession.

Validity of a life policy may be questioned.

Difficulty in admission of age.

Suicide and death punishments

Liability for payment of premia

It is voidable.

Difficulty in case it is not taken possession of.

Mortgage of immovable property is, in many cases, required to be legal, and this is both expensive and inconvenient. It is also diffi-

Difficulty of legal mort-

gage in ascertaining title and value. *cult to find out the title of an immovable property because of the peculiarity of both Hindu* and Mohammedan *Laws of Inheritance. Then,* it is also difficult to form a correct estimate of

Value precarious. the value of an immovable property. Again, it is subject to heavy fluctuations. There is also a

Difficulty in realisation. good deal of difficulty in realising it. A number of legal formalities are required to be observed. Besides, it takes a good deal of time to find out a purchaser. Further, different values are attached to the same property by different persons and at different times. Certain kinds of house property

Question of repair. also deteriorate rapidly in value if they are not kept in a proper condition of repair. From the time of the acquisition of a house property on the expiry of the period of debt to the time of

Difficulty of finding out a tenant. sale to somebody else, the banker has also to find out tenants and arrange for repairs. It is also extremely difficult and inconvenient to find

Deed may not be genuine. out whether the deed to an immovable property is genuine and correct. In cases of leasehold property there is always the danger of the for-

Forfeiture of lease possible. feiture of the lease as well due to the non-payment of ground rent. Finally, there is a danger of loss to the property by fire.

Q. 123. X Bank starts operations with a subscribed capital of Rs. 1,200,000 of which half has been paid up. It receives a deposit of Rs. 10 lakhs from the investing public. It discounts bills of exchange for Rs. 7 lakhs, grants loans and overdrafts to the extent of 3 lakhs. Out of the cash in hand the bank invests half in Government securities.

Draw up a Balance Sheet of the X Bank showing the above entries. *(U. P. 1931)*

A.

X. BANK LIMITED

Balance sheet as on.........

Liabilities.		Assets.	
Subscribed capital :— ......shares of...... each	Rs. 1,200,000	Loans and overdrafts	Rs. 30,000
		Bills discounted	Rs. 700,000
Paid up capital :— ......shares of...... each	Rs. 600,000	Investments in Government Securities at cost	Rs. 300,000
Deposits	Rs. 1,000,000	Cash in hand	Rs. 300,000,
	Rs. 1,600,000		Rs. 1,600,000

Q. 124. Draw proforma Balance sheet of a joint stock bank, and briefly explain the various items in it. *(U. P. 1943)*

A. Proforma Balance sheet

THE JAMMU AND KASHMIR BANK,

Balance Sheet as on

Liabilities.	Rs. as. p.			Rs. as p.		
Capital :—						
Authorised :—						
200,000 shares of Rs. 25 each	5,000,000	0	0			
Issued :—						
80,000 shares of Rs. 25 each	2,000,000	0	0			
Subscribed :—						
63,131 shares of Rs. 25 each	1,578,275	0	0			
Amount called and paid up @ Rs. 1218 per share	789,137	8	0			
Less allotment and call money in'arrears ...	12,890	0	0			
				776,247	8	0
Deposits :—						
Fixed Deposits ...	1,021,773	12	11			
Savings Banks Deposits	511,849	2	8			
Current and Deposits at call	1.184,982	0	0			
				2,718,605	13	6
Other Liabilities :—						
Bills payable ...				4,203	3	0
Branch Adjustments ...				25,577	9	6
Bills for collection as per contra				66,799	2	3
Profit and Loss Account						
Net profit for the year	47,495	13	6			
Less loss for last year	6,995	13	6			
				40,500	0	0
	Total ...			3,671,933	4	3

of a joint stock bank.

LIMITED, H. O. SRINAGAR

30th June, 1941.

Assets	Rs. as p	Rs. as p.
Cash in hand	503 294 10 0	
Cash with banks in current a/c ...	1 165,710 0 4	
Loans and Demand advances		1,669,004 10 4
Particulars required by the Companies Regulation No XI of 1937		
(i) Debts considered good in respect of which the bank is fully secured	1 719 660 0 9	
(ii) Debts considered good secured by the personal liabilities of one or more parties as under		
(i) Debts due on bills purchased . .	72 299 7 6	
(ii) Debts due on single and joint pronotes	87,480 14 8	
(iii) Temporary overdraft	3 402 3 9	
(iv) Debts due by Directors and other officers of the bank .	96 0 0	
(v) Debts due by firms and Companies in which a Director of the bank is a partner or guarantor	Nil	
(vi) Debts considered bad	Nil	
Furniture and Fittings at cost	4,845 13 9	1 889,497 10 8
Less Depreciation upto 30 6 41	261 0 3	
		4,854 13 6
Bills receivable as per contra .. .		66,799 2 8
Stamps stationery and books in hand at cost		1,596 15 6
	Total	3,631,933 4 8

Explanation of the various items in it.

Liabilities. First of all, there is capital, Authorised capital is the amount with which, this bank has been registered. It can sell at the most 2,00,000 shares of Rs. 25 each. Registration fee is paid on this amount. A change in authorised capital is not easy. Next, all these shares have not been offered to the public. Only 80,000 shares have been so offered. The balance can be offered at any time, when there is felt a need for a larger capital. Then, all the shares issused by the bank were not subscribed to by the public. This shows that the bank was not popular in the beginning. Only 63,131 shares were subscribed to Rs. 1218 was called on each share. The remaining can be called at any time, and is a reserved liability of the share-holders. This is good from the point of view of depositors, as they can get at the time of the winding up of the bank a larger amount than what is realised out of the sale proceeds of the assets.

Deposits consist of money on fixed, savings banks and current a/cs. In the case of fixed a/cs. money can be withdrawn only after the expiry of a fixed period. In the case of savings bank a/cs as well, there is some restriction. Only a limited amount can be withdrawn at one time and that too not usually more than once a week. In the case of savings bank a/cs, however, money can be withdrawn to any extent and as often as possible. This is demand liability of the bank, and must be paid when demanded.

Other liabilities consist of bills payable, branch adjustments and bills for collection as per contra. Bills payable are the bills accepted by the bank.

Branch adjustments consist of amounts held on behalf of customers and payable to the parties directed by them through different branches. Supposing, A deposits money in Sri Nagar for payment to B in Jammu, it will be shown in cash, and as a branch adjustment. Bills for collection as per contra are bills accepted by the bank on behalf of its customers. On the assets side, this has been shown under the heading bills receivable as per contra. They will be paid by the customers on whose behalf they have been accepted before they become due. But if they are not paid by them, the liability is that of the bank, and hence they have been shown here.

Under profit and loss account, there is the profit for the current year from which loss for the previous year has been deducted.

Assets. Cash in hand is the balance with the bank itself. Cash with banks in current account is the balance of the bank with other banks. This can also be withdrawn at any time and hence made available as cash.

Loans granted by the bank have been shown under different headings as required under the Indian Companies Act. First of all, there are debts considered good in respect of which the bank is fully secured. It must have collaterals for them which can be realised if necessary. Next are debts considered good secured by the personal liabilities of one or more parties. There are always certain customers who are men of unimpeachable reputation and sound financial position, but cannot or do not like to offer collaterals. They must be given accommodation,

as the bank can ill afford to displease them. Such debts may be in connection with bills signed by the borrowers or those signed by the borrowers and certain other persons standing as sureties for them. Thirdly, banks allow some of the customers who maintain current accounts with them to overdraw their current accounts. Temporary overdraft represents aggregate amount of such overdrawn accounts. Debts due by Directors and other bank officers are required to be shown separately. Similarly, debts due by firms and companies in which a Director of the bank is a partner or guarantor must be shown quite distinctly. Finally, debts considered bad are also required to be shown separately.

Furniture and fittings have been first of all shown at cost, and then total depreciation provided upon them has been deducted from the cost value.

Bills receivable as per contra have already been explained in connection with liabilities.

Stamps, stationery and books have been shown at cost. They are meant for use and will be written off.

Q. 125. Mention the important considerations which would guide you (a) as a businessman in selecting your banker, and (b) as a banker in admitting a new customer. (*U. P. 1940*)

Proportion of cash reserve to total assets and total demand liabilities.

A. **Important considerations in selecting a banker.** The important considerations guiding in the selection of a banker will be diverse. First of all, the proportion of cash reserve to (*a*) total assets, and (*b*) total demand liabilities

will be seen. The solvency of a bank does not merely consist in an excess of assets over liabilities. Many banks have failed in our own country in spite of their having good excesses of this kind. What it consists in is an easy liquidity of the bank's resources. It is, however, very difficult for all the resources of a bank to be easily liquidated. This necessitates, therefore, the maintenance of a good cash reserve. What is a good cash reserve is again a question of much dispute. But the businessman has to find it out by exercising his own judgment in each case.

Proportion of paid up capital and reserve to total liabilities.

The proportion of paid up capital to total liabilities is also very important. The amount of reserve fund may also be added to it. Banks building high business on the basis of small capital generally come to grief Then, there are banks with very big authorized capital but a considerably small paid up capital. In fact, the amount of paid up capital is important.

Reserve liability of the share-holders.

A bank having partly paid up capital is better than a bank having fully paid up capital. The difference between the amount paid up and that of the shares constitutes a reserved liability on the share-holders. This means that in the event of final dissolution of the bank due to failure to meet its obligations, the share-holders will be called up to pay the balance due on them. The depositor will surely be benefited by this call.

Distribution of shares over a larger number of people.

If the shares are distributed between a large number of people, reserved liability will be easily recovered. It is comparatively more difficult to realise large amounts from small number of share-holders.

The nature of the loans usually granted by

Nature of advances made.

the banks would also be gone through. Although advances cannot, as a rule, be made to bank employees, yet they cause the funds to flow out according as they wish. It has not infrequently been found that the advances were made by the bank authorities to their favourites on inadequate securities.

A scrutiny of the values of investments.

The values of the bank investments would also be scrutinised. If the general tendency at a particular time warrants a shrinkage, the particular bank must not be selected.

Nationality etc.

Over and above the points mentioned herein, certain other things will be seen. For instance, a bank belonging to the same nationality as the businessman may prove of more advantage to him. The authorities will surely be sympathetic towards him. The character and personality of those incharge also count a good deal.

Important considerations in admitting a new customer. A banker would also be guided by certain important considerations in admitting a new customer. The rule of asking for an introduction of the new customer before his admission by some old customers or employees of the bank or some persons of repute is well observed by banks in many countries. The banker should see that the customer to be admitted has a good character. Those having a bad record, say, of fraud, theft, etc., should not be admitted. He must be temperate in habits A drunkard should be avoided as far as possible. Minors should also be avoided. The law lays down that a minor may draw, endorse, deliver and negotiate cheques, bills and promissory notes so as to bind all parties except himself. It

Introduction.

Personal character.

Minors may be avoided.

is argued that cheques drawn by a minor can be repudiated by him on his attaining age. If a cheque or bill endorsed by the minor in discharge of a debt is accepted by the bank, it is not entitled to proceed against him in case such cheque or bill is dishonoured. Capacity to incur liability is consistent with capacity to contract, which the minor does not possess. It follows, then, that the banker should not in any case allow the minor customer to overdraw his account.

Agents or employees. While opening accounts which are to be operated by agents or employees, the banker should see that the agents or employees get full power. **Joint accounts.** Similarly, while opening joint accounts, it should be obtained in writing from all the parties concerned as to what signatures would be necessary to operate on the account. **Trust funds** Those incharge of trust funds should be dealt with very cautiously, as the courts are very particular about the safety of such funds, and in case they are misappropriated, hold the banks responsible if they could check the misappropriation by exercising even a little business talent.

APPENDICES

SHORT NOTES

Cash credit. Please refer to the discussion of this topic in answer to Q. 117.

Liquid Assets. These are the assets consisting of cash in hand or with the central bank.

Window dressing. Banks publish their

balance sheets at least once a year. When the time for publication draws up nearer and nearer, a good many of their try to realise as many of their assets as possible so that they may be able to show a very high percentage of cash reserve to their liabilities. There are several other ways in which they may try to show a better position of their business. When they do so, the action is known as window-dressing.

Till Money. A bank has to keep some hard cash to meet day to day cash demands of its customers. The money so kept is known as *till* money.

SUPPLEMENTARY QUESTIONS

Q. 1. What are the functions of a bank ?—
(*Rajputana*)

A. For the principal functions please refer to the answer to Q. 107.

Miscellaneous functions of a bank include (*a*) transactions of foreign exchange business, and (*b*) safe custody of valuables. Formerly, banks also issued notes. At present, this right is confined in most of the countries only to central banks.

Q. 2. On what principle can a bank lend other people's money for long periods and yet pay the claims made upon it on demand or at short notice ? How much may a bank lend ?
(*Rajputana*)

A. A bank can lend other people's money for long periods and yet pay the claims made upon it on demand or at short notice because most of the demands are made in cheques which are

either credited to the payee's account or offset in the clearing house. Again, cash demands are enabled to be met out of the daily cash receipts. Besides, a bank also holds bills and certain other forms of investments which can be easily realised at any time. (For a detailed answer to this question please refer to the answer to Q. 108.)

Q. 3. Bank deposits in modern times have changed from cash deposits to deposits of credit. Explain. (*Calcutta, B. A.*)

A. Please refer to the answer to Q. 108.

Q. 4. By what principles should a banker be guided in granting credit to his customer ? What investments are most suitable from the banker's standpoint ? (*Punjab, B. A.*)

A. Please refer to the answer to Q. 110.

Q. 5. State the functions of Commercial Banks. What type of security is preferred by them for the loans advanced and why ? (*Allahabad, 1940*)

A. For functions, please refer to the answer to Q. 107 and for securities to that to Q. 121.

Q. 6. (*a*) A failure to realize the difference between immediate and ultimate convertibility will lead a commercial bank into difficulties. Discuss.

(*b*) A clean advance on a single name paper is not less secure than an advance on a two name paper. Discuss. (*Allahabad, 1941*)

Answer to (*a*) part of the Q. can be given with the help of the answer to Q. 120.

Answer to (*b*) part of the Q. can be given with the help of the answer to Q. 121.

Q. 7. Comment upon the following :—

(*a*) 'A scientific banker should realize the fundamental difference between a B/E and a mortgage.'

(*b*) 'Bank loans create deposits.'

(*Allahabad, 1943*)

Answer to (*a*) part of the Q. can be given with the help of the answer to Q. 120.

Answer to (*b*) part of the Q. can be given with the help of the answer to Q. 108.

CHAPTER XV

CENTRAL BANK

[ITS FUNCTIONS—BANK OF ENGLAND—BANK RATE—CLEARING HOUSE.]

Q. 126. Enumerate the functions of a central bank. Explain how the Bank of England performs the functions of a central bank.

Diverse functions.

A. **Introduction.** The functions of a central bank are many. We will discuss them herein and see how far Bank of England performs them.

Bank of England enjoys this privilege.

Bank charter Act of 1844.

Monopoly of Note-issue. (1) A central bank has the monopoly or note-issue. No other bank in the country or Government has this right. Bank of England enjoys this privilege. The Bank Charter Act of 1844 forbade all other banks to issue notes except those issuing it on a particular date. Besides, there were certain provisions in the Act which resulted in the gradual lapse of this right of even these banks, the last of them losing the right in 1921. Bank of Englaud, however, issued notes of the denominations of not less than £ 5. During the War of 1914, the Government also began to issue notes of the denominations of £ 1 and 10*s.* The Currency and Bank Notes Act, 1928, however, transferred to the bank the privilege of issuing even these notes. The Government's liability on such notes circulating at that time was transferred to the

Recent history

bank. Since then, it has been enjoying the monopoly.

Metallic currency issued and taken back through it.

Sole channel for the out and intake of legal tender currency. (2) It is the sole channel for the out and intake of legal tender currency. Besides notes, there is also some metallic currency. But the mint authority issues it through the bank. Bank of England enjoys this right also. Whatever metallic currency is in circulation in England is issued by the Government through this bank. If it has surplus the same can be returned by it.

Various accounts.

Holder of all Government balances. (3) It holds all Government balances. Bank of England issues a Weekly Return. We can find in it the item of Public Deposits. It includes Exchequer, Savings Banks, Commissioner's of National Debt and Dividend accounts.

No legal binding upon banks to maintain a minimum balance, yet they maintain.

Bankers' Bank. (4) It is the holder of all the reserves of the banks and branches of banks in the country. Bank of England is a banker's bank. Though the banks of the country are not obliged by law to maintain a minimum balance with them, as is the case with central banks of many countries, they maintain a balance. Bank of England acts as a clearing house, and hence all the banks keep their money with it. Besides, as they can draw money from this bank whenever they like, a balance with it is as goods as cash in hand. It also provides them with emergency currency on the basis of the bills rediscounted by them with it.

Provision of emergency currency.

All receipts and payments are

Government's agent for all financial operations. (5) It acts as an agent of the Government, and all the financial operations of the

same at home and abroad are performed through it. Bank of England receives money on behalf of the Government at home and Exchequer's cheques are paid by it. All foreign debts of the Government are also settled through it. It keeps its accounts with almost every central bank and thus settles Government accounts in foreign countries. All public debts are managed by it. It advises the Government as to the suitability of the time or otherwise of debts, and arranges to receive and repay them.

made through it.

Management of public debt.

Stabilises currency value. (6) It effects suitable expansion and contraction with a view to maintain stability of currency both within and without the country. Bank of England does this through its bank rate and open market dealings. Whenever it feels the necessity of expansion, it lowers the bank rate, and thus encourages rediscounting. Banks transfer their bill portfolio to it, and obtain notes. It raises its rate of discount, if it feels the necessity of checking expansion. If necessary, it resorts to open market dealings which mean purchase and sale of securities in the open market by the bank. When it sells securities there is contraction and when it purchases them there is expansion.

Bank rate

Open market operations.

Q. 127. What do you understand by the bank rate and what is its relation with the money market? *(U. P. 1932)*

A. **Definition.** Bank rate is the official minimum rate at which a central bank is prepared to discount bills. It differs from the market rate of discount in that it is normally higher and in that it is not a constantly fluctuating rate shifting with the supply of, and demand

Points of distinction between

rate.

for bills, but is fixed and announced on a particular day in every week as a result of the deliberations in a special meeting of the Bank Directors, and except under most unusual circumstances, it is not changed on any other date. The market rate is, on the other hand, the rate at which the other banks, including bill brokers, if any, are prepared to discount bills. This rate is arrived at by competition among different members of money market and is a result of much higgling. It may change several times in a day.

Its effects. Bank rate has a close effect upon the money *market in western countries, as we shall see presently. But it has no such effect upon the money market in India. In fact, in India there is no one money market, but a number of markets. The rates prevailing in them have no regular connection with the Reserve Bank of India rate. Formerly, when this Bank had not been established, Imperial Bank rate was the bank rate. It was the rate at which the bank was prepared to grant loans against Government Securities. This was not always the minimum rate at which credit was available. In contrast with the bank rates of other countries, it was also the rate at which it was prepared to grant loans against Government securities, and not discount bills or hundis. There was a separate Imperial Bank hundi rate for this purpose. With the establishment of the Reserve Bank of India, however, the nature, etc., of the bank rate have changed, but a regular connection has, even now not been secured bet-

Difficulties in India.

Imperial Bank rate and its peculiarities.

B. R. since the establishment of R. B. effective.

*See meaning of Money by Withers.

ween it and the money market. As has already been pointed out, there are a number of money markets in this country. An attempt has been made to establish their connection with the modern banks by making it compulsory for them to deposit 5% of their demand and 2% of their time liabilities. But there are indigenous bankers who are, by far the most important than the modern banks, and no attempt has so far been made to establish a connection with them. Stock Exchange operations as well which play an important part in England seldom play any part here. Then, the use of bills is not very popular. Export bills, because of peculiar circumstances created by the foreign exchange banks, have to be immediately sent out of India, and are rediscounted, if necessary, in the London market. Import bills are held by exchange banks themselves until they mature. If they are accepted by London bankers on behalf of the Indian importers, as is usually the case, they are rediscounted there and do not enter the Indian market.

Connection with the modern market.

Stock Exchange operations.

Bills not popular.

Both our export and import bills are discounted in the London money market.

Quite contrary to this are the conditions in England. There, the bank rate determines, to a large extent, other rates. It is regarded by people as standard rate for money. Hence, when depositors desire to deposit money they try to get interest rate in relation to the bank rate. Bill-brokers or banks must also charge a rate higher than what they themselves pay for deposits. Thus, the discount rate of the money market is determined by the deposit rate which, in its turn, is dependent upon the bank rate. Normally, there is a wide divergence between market rate and bank rate, and people prefer to discount with

Bank rate effective in England.

Deposit rate related to bank rate.

Market rate of discount also related to it.

Normally market rate is lower than the bank rate.

other banks who charge a very low rate. They are also more accommodating. At such times bank rate is not effective. But during the period of stringency, it becomes very effective. Other

Its effectiveness during the periods of stringency.

banks having no means left with them to lend more, approach the Bank of England for the supply of funds. It does so at its own price. When money is very cheap in London and foreign bills are received there for discounting, balance of indebtedness increases and gold flows out of the country. In order to check this also it enters the market, and borrows money which it does

Outflow of gold checked by borrowing money from the market.

not need. This results in the curtailment of the power of granting credit by banks and their rate of discount ultimately goes up, thus checking the outflow of gold. From this discussion it is quite clear that bank rate in England has a close relation with the money market. It is so in other important countries also.

Q. 128. Describe briefly but clearly the organization and working of a banker's clearing house, indicating its advantages to bankers and to society. *(U. P. 1940)*

Reciprocal liabilities are offset.

A. **A banker's clearing house.** A banker's clearing house is an institution of credit where reciprocal liabilities of the banks, of a particular

Principles of working.

place, are offset against one another. The principle on which it works is quite simple. Every bank takes to it all the cheques and bills owing to it and payable by other banks. In return it receives all bills and cheques it has to pay to the other banks. A balance is struck and received or paid by means of a cheque on the central bank or any

An illustration.

other big bank wherein the clearing business takes place. Suppose, there are, for our purpose, four

clearing bankers, namely, A, B, C, and D. Each of these banks keeps specially ruled sheets known as 'Summary Sheets of 'Out-clearing' wherein the records of all cheques or bills drawn on or payable at other banks are made. Thus, if Bank A on sorting cheques and drafts in its possession, finds claims against Bank B, it will enlist the same on the sheet. Similarly, claims against other banks will be enlisted. After this, cheques etc., are carefully checked and bundled up separately. These bundles are then taken to the clearing house and put on clearing desks of the member banks respectively. There, the clerks of the respective banks make their record, in what are known as 'Summary Sheets of In-clearing', in the same way as the record had been made in 'Summary Sheets of Out-clearing.' If the total of out-clearing of Bank A against Bank B is greater than the total of in-clearing of the same from the other, it has to receive a balance and *vice-versa*. Then, these balances, as shown by the sheets, are entered upon a list known as the 'General Balance Sheet' of the particular bank. This list contains printed names of the member banks with Dr. and Cr. money columns on the left and right sides respectively. If an amount is to be received from a bank, it is entered on the debit side just in front of the particular bank's name, and *vice-versa*. A balance is then struck out of the debt and credit totals and instructions for transfers are given to the central bank. For instance, if Bank A has to receive a balance it directs the central bank to transfer the same from the clearing house account to its own account, and *vice-versa*. Thus, the entries in the accounts of the

member banks with the central bank are made as also with the entries in the account in the name of clearing house. It must also be noted that the cheques upon different banks are sent to their respective offices and in case any of them is refused there, it is treated as an out-clearing for the refusing bank.

Advantages. This organization is advantageous both to the bankers and society at large. It is advantageous to the bankers inasmuch as they are not required to send their men to each bank separately. Neither are they required to receive or pay in cash unnecessarily. This provides for an additional advantage, *viz.*, that of the necessity of keeping not very large sums in hand. It is advantageous to the society also as the same can do with less amount of cash. It benefits also by the extension of credit due to the increasing use of cheques encouraged by their settlement through this system.

Economy of labour and cash.

Encouragement to the use of credit instruments.

Q. 129. Describe the operations of the English clearing house system. Vindicate the need of such an institution in this country.

(U. P. 1934)

A. **Description.** The English clearing house system or the London banker's clearing house system is divided into three sections :—

Three sections.

(*a*) Town clearing.

(*b*) Country clearing.

(*c*) Metropolitan clearing.

Town clearing.

Twice per day.

Town clearing covers an area within easy walking distance from the Bank of England. Ordinarily, two town clearings are effected each day, one in the morning and the other at the

afternoon. Each clearing bank sends round to the clearing house, at the times fixed bundles of cheques known as charges—each for different banks. These are exchanged, entered and added, and so far as possible totals are verified. A balance is then struck out from in-clearings and out-clearings from and to each bank. This then is entered on the General Balance Sheet on the debit or credit side, as the case may be, just in front of the name of each bank printed therein. Both the columns are then added up and the difference represents the total sum owing to or by the bank in question on 'general balance.' Each bank keeps an account at the Bank of England, and there is also an account called the clearing banker's account and the differences are settled by transfers between these accounts.*

Country clearing.

Country clearing consists of the clearing business of practically every bank and branch bank in England and Wales outside the metropolitan district. Every country bank appoints one clearing bank in the city of London as its agent for this business. Hence, they receive cheques drawn on other country banks from their branches and correspondents. The process followed here is the same as that in town clearing. There is, however, only one country clearing on each day. The general balance ascertained from the General Balance Sheet prepared in connection with country clearing is not settled directly but through the town clearing of the next day but one—it being included in the same Balance Sheet. This delay is due to the fact that the cheques are sent to the different country banks

Only once a day.

Settlement through town-clearing of the next day but one.

*For detailed operations please see answer to Q. 128.

and settlement is made only on receipt of information from them.

Metropolitan clearing.

Metropolitan clearing was inaugurated comparatively late. It embraces cheques and drafts received from the branches or correspondents of the clearing banks outside the town and country clearing areas drawn upon the banks situated therein. These are sorted and presented to the head offices of the branches and agents of the other banks. The balance in the General Balance Sheet of the metropolitan clearing also is transferred to the General Balance Sheet of the town clearing of the next day. Just like the country clearing there is only one clearing of this also each day. Each clearing bank on receiving the charges sorts them out and sends to the drawee banks for honouring. The information is received by the next day.

Settlement through the town-clearing of the next day.

One clearing each day.

In case any cheque or draft is returned dishonoured it is regarded as an instrument for out-clearing of the particular clearing.

Treatment of dishonoured instruments.

It must also be noted that drafts are not included in the country clearing, while in the town and metropolitan clearings they too are included.

Drafts not included in the country clearing.

India. In India, there are at present clearing houses in a number of important towns. In fact cheques are not very popular here. Then, clearing business in this country has not been divided into sections just as it has been divided in England. There is, however, the need of clearing houses in some other towns where business is considerably huge. Each bank has to send its men to different banks for the collection of cheques. There is considerable risk in this.

No division into sections.

Need in some other towns also.

Besides, much time is uselessly wasted and currency passes from one hand to other for being returned again.

APPENDICES

I

SHORT NOTES

Bank of England Notes. Bank of England notes of £5 and upwards are legal tender in England and Wales, but not by the Bank itself. Bank of England notes of £1 and 10s. issued under the currency and Bank Notes Act, 1928, are legal tender in Scotland, and Northern Ireland also, and for the payment of any amount including payment by the bank itself. They are now inconvertible. The total amount of notes issued on March 29, 1939, was £526,160,005.

II

SUPPLEMENTARY QUESTIONS

Q. 1. What are the effects of (*a*) arise in the bank rate and (*b*) a fall in the bank rate on the trade of a country? (*Rajputana*)

Effects of a rise or fall in the bank rate on the trade of a country. When the bank rate is raised, the rates of all kinds are raised in the money market of the particular country if the same is in control of the central bank. In case, however, if this is not done automatically, the central bank enters into competition with other banks by taking up to direct business in the market and this has the desired effect. When all sorts of rates rise, credit becomes dear, and banks' power to manufacture it goes down. This

results in the curtailment of all activities. Trade becomes slack and everywhere there is pessimism. Quite opposite is the result of the fall in the bank rate (Students are referred to the answer to Q. *127.)*

Q. 2. What do you mean by the term bank rate ? Explain the factors which operate to bring about a fluctuation in such a rate during different periods of the year. (*Rajputana*)

(Students are again referred to the answer to Q. 127, specially for the first part.) Bank rate should in fact be steady throughout the year. It may be fluctuated only if the currency and credit is to be inflated or contracted. Perhaps bank rate here has been referred to the Imperial Bank rate. It fluctuated during different periods of the year. When there was a great demand of currency and credit to finance the movement of crop the rate was raised and during slack season it was lowered. This is in fact not a good practice. Reserve Bank of India rate has been steady since it was fixed at 3% on 28th November, 1935.

Q. 3. Describe the functions of a Clearing House and its economic services. (*U. P. 1942*)

An answer to this question can be given with the help of the answer to Q. 128.

CHAPTER XVI

MISCELLANEOUS

Q. 130. The two greatest events which have occurred in the history of mankind have been directly brought about by a successive contraction and expansion of the circulating medium of society. Comment on the above. Illustrate from contemporary economic events. (*U. P. 1934*)

***Author's Note.** The statement is awfully vague and cannot be commented upon with any exactness. First of all, 'circulating medium of society' does not convey any idea. But we could proceed by taking it to be circulating medium of exchange Then there is another difficulty. It is not possible to say definitely as to which of the two events have been referred to here. Some regard the birth of Lord Buddha and Lord Jesus Christ as the two greatest events in the history of mankind. Others regard the development of the languages and discovery of fire as the two greatest events. But these events have to do nothing with currency. If we confine ourselves to economic history, there is again the same difficulty. Some regard the discovery of steam power and the introduction of the Joint-Stock principle as the two greatest events. Others

*The author has consulted a number of learned Professors with regard to the answer to this question and this note has been prepared in consultation with them. The responsibility of the answer, however, rests entirely with the author. There may be difference of opinion.

regard other things. But these too have to do nothing with currency. Expansion and contraction of the circulating medium of exchange have, of course, very far-reaching effects and we may here discuss them in the light of the events in the present century. But these events cannot be claimed to be so important as to be regarded as the greatest events occurred in the history of mankind.

A. **Effects of expansion and contraction of currency during the War of 1914-18 and after that specially in U. K. and U. S. A.** During the last European War there was an expansion of the circulating medium of exchange in almost all the countries of the world. In some countries it went on even after the war. We know what happened in Germany, Russia, Poland, Austria and Hungary. Let us, however, take here U. K. and U. S. A. U. K. spent during the war 10,000 million pounds. Only a third of this was collected by increased taxation. The balance was met by borrowing which resulted in expansion of the circulating medium of exchange. This was responsible for the rise of a number of maladjustments. The Government, however, decided to endeavour to restore the pound to its former gold parity value by following what is known as a deflationist's policy. Price deflation in the country was, however, harmful to industry, mainly because wages could not, in the then existing state of public sentiment, be reduced as the cost of living fell. Unemployment increased. Appreciation of pound brought about the general strike of 1926 in U. K.

Expansion in U. K.

Followed by contraction.

General strike in 1926.

Coming to U. S. A., we find that, with the relaxation of wartime controls on the cessation of the

Expansion in U. S. A.

hostilities, there was credit expansion all through 1919 accompanied by rising prices and increasing speculation. Efforts to control these developments were delayed by the Government's desire to maintain cheap money rates until the Treasury had reduced the unwieldy floating debt. In the last week of January, 1920, however, discount rates of the Federal Reserve banks were raised. As further increases were made, rise in commodity prices was checked. Collapse followed. The fall in prices was such that all debts were practically doubled in burden. This fall, however, ceased in U. S. A., in January, 1922, and from that date onward there was price inflation in that country. It resulted in rising prices, rising profits, wild speculation of a boom and the eventual crash of 1929.

Successive deflation.

Again inflation.

Its results.

Conclusion. From the above we can say that there was a successive expansion and contraction of the circulating medium of exchange in U. K., and that there was a successive contraction and expansion of the same in U. S. A. Both policies affected and conditioned by many other happenings, of course, resulted in the two greatest events, we cannot say in the history of mankind, but surely in the history of U. K, and U. S. A., namely the General Strike of 1926 and Wall Street Crash of 1929.

Q. 131. Trace clearly how the bank note marks the first step in the development of banking or in other words in creating the machinery for the manufacture of credit.

How far can you explain the growth of indigenous banking to such beginnings ?

(U. P. 1934)

A. **Bank note marks the first step in the development of banking.** There was a good deal of disturbance in England during the period immediately preceding the Commonwealth. It was at this stage that the people conceived the idea of entrusting money to the goldsmiths who *received it in safe custody and gave in exchange receipts in the form of promissory notes payable to bearer. Very soon they came to be known as* "goldsmiths' notes", and if we can consider the goldsmiths as bankers taking deposits, it may be claimed that their notes constituted the earliest form of *English bank note.* The operations of the London goldsmiths were many and varied and ranged from the care of valuables, money-changing, the buying, selling and melting down of gold and silver to the in-gathering of deposits. But ultimately the deposit-business attracted them the most. In fact, this was the beginning of banking and it was due to the emergence of bank notes as we shall see presently.

Earliest forms of English bank note.

Diverse business of goldsmiths.

Development of deposit business

At first, goldsmiths did not pay interest on the deposit of money with them, but as they extended their operations and began to buy bills of exchange under discount, they found it desirable to encourage clients by offering interest on deposits. They also agreed to pay these loanable funds on demand. In reality, the goldsmiths, originally receiving only deposits, considerably developed the money-lending side also to their business. They made loans of not only specie, but of credit too, based on actual specie in their possession. In course of time they, however, found by experience that demands for payment were small and began to issue notes considerably in excess of the cash they had available to meet them. Thus, we see

How interest began to be allowed on deposits

Development of money-lending business in the form of notes.

Issue of notes in excess of

that bank note marks the first development of banking or in other words in creating the machinery for the manufacture of credit. In fact, with the issue of notes in excess of the cash available, the well-known maxim of banking, *viz.*, banker's brain and other's money began to be applied.

the cash available.

Conclusion.

In course of time some of the goldsmiths, dropped out money-lending business and concentrated on the better class of business akin to present-day banking. They became, in fact, private bankers. Those of the goldsmiths who thus took upon themselves the role of private bankers found their business rapidly extending.

Present-day banking.

The record of the goldsmiths is important, as it was from them that banking was evolved in England and then all over the world. First, they were purely custodians for valuables; then their operations involved three distinct functions—deposit banking, note-issuing banking and discount banking.

Importance of the records of goldsmiths.

The Bank of England came into existence with power to issue notes. For long, joint stock banks did not flourish in the country as they could not issue notes. But later on, cheque system was evolved, and this further led to the spread of banking in the country.

Evolution of cheque system.

Indigenous Banking. Growth of indigenous banking can, however, be not explained to any such beginnings. Indigenous bankers have long been using hundis, and whatever banking business they did was by the use of hundis. They were drawn for almost all banking purposes, *e. g.*, for manufacturing credit, for financing trade and industry and for the remittance of money from one place to another.

Importance of hundis.

APPENDIX

Open market operations. *These operations* mean purchase and sale by the central bank in the market of any kind of paper in which it deals, and as during the war of 1914—18 enormous *quanity of Government securities were issued in* almost all the countries, the central banks purchase and sell now only these. Other public securities are for obvious reasons disregarded by them. The principal reason for using the term : open market operations for these actions of the central bank is that it goes itself to the market instead of the market going to it.

But these operations may be effective only under certain conditions. First of all, it presupposes that banking habit has considerably developed in the country and that there is no surplus money lying in hoards, which may be used for the purchase of securities when they are sold by the central bank. Besides, the effect may be counter-balanced if the securities are purchased by the foreigners who send gold in exchange for them. Secondly, it is necessary that any increase or decrease in the cash or bank balances of the commercial banks must have its repurcussion directly on their manufacturing of credit. There are many circumstances when commercial banks are deterred from employing increased cash or bank balances for the manufacture of credit or *vice versa.* Then, it is not only the question of the willingness of the commercial banks to act in the desired direction, it is also the question of the preparedness of the entrepreneurs to take the risks and the availability of the reliable borrowers. In the absence of both of these, an

expansion of credit does not take place in spite of the willingness of the banks to do so. Conversely, the prospect of business and speculation may appear so attractive to the entrepreneurs that the banks may not be able to reduce their demand for credit even if they try to do that. *Finally, there is the need of the velocity of the* bank deposits to remain constant. Ordinarily, this velocity tends to increase during periods of rising business activity and decrease during those of declining business activity. However, in practice none of these conditions are found in existence to the full extent in any of the countries. But normally open market operations are considerably effective in at least the most important countries these days. The significance of the open market operations is that they tend to increase or decrease the supply of bank cash and that such changes ordinarily tend to bring about changes in money rates and credit conditions which in their own turn bring about corresponding adjustment in the price-level and general business activity. If there is a break anywhere, the desired effect is not obtained.

INDIAN BANKING

CHAPTER XVII

INDIAN JOINT STOCK BANKS

Q. 132. Discuss some of the causes of the backwardness of Indian Banking. What steps have been taken by Indian Joint Banks in recent years to popularise banking in India ?

(*U. P. 1931*)

Varied causes.

A. **Introduction.** The causes of the backwardness of Indian Banking are varied. We shall be able to discuss here only some of them.

Lack of encouragement from Government.

Causes. (1) Indian banks do not receive encouragement and support from Government to the extent desirable. Its officials and public bodies keep funds with Imperial Bank. They ought to patronise other banks also. Besides, all payments should be made by them in cheques.

Competition of exchange banks.

(2) They have to face the competition of exchange banks which have got their branches not only in important ports, but also in towns. The business at such places is mostly in their hands. Indian banks have to be satisfied only with the less profitable business of the small places. The exchange banks have been so successful in important towns and ports not because of the incapability of the Indian banks, but because of the fact that a considerable business of the country being in non-Indian hands, they give preference to the banks of their own

Causes of their success.

country. Those of the Indian businessmen also who are in subordinate relations to these are compelled by them to have their dealings with foreign banks.

(3) Numerous bank failures have discouraged investment in the shares of the banks. Depositors also are very suspicious of them. **Numerous failures.**

(4) Some Hindu and Mohammedan laws and customs regarding succession to, and transfer of rights in, immovable property make it unsafe for the banks to give loans on the security of s.ch property. Equitable mortgages are also allowed only in certain important towns. **Peculiarities of certain laws in the country.**

(5) Bills, being not very popular in this country, investment in them is not possible to any considerable extent. They provide the best form of investment to the banks, and in their absence, they suffer. **Bills not very popular.**

(6) Indian banks do not grant clean advances to any appreciable extent. In fact, in the absence of agencies like Seyd's in England and Dun's and Bradstreet's in U. S. A. for supplying the banks with information regarding the financial status of the borrowers, banks in this country are not in a position to make such advances. **Absence of clean advances.**

These are the causes over which banks have no control. Then, there are certain others which have, to some extent, been removed by them in recent years.

(1) All banks conduct their work in English and their cheque books, pass books, and pay-in-slips are printed in English. The number of the banks, recognising cheques and signatures **Use of a foreign language.**

in Hindustani has, however, been increasing for some years.

Imitation of whole-sale European methods.

(2) The banks have imitated European models. In fact, these have not been found suitable for this country. It is, however, a matter of satisfaction that some of the banks have recently shown some initiative in chalking out new lines. *They have reduced their cost of management by resorting to simplicity.* In many cases European managers have been replaced by Indians.

Establishment of small offices in small Mandies is helping them.

(3) Attempts have recently been made to establish small offices in Mandies. These finance the Arhatias who finance agriculture. This provides for the investment of their funds, and cheapening of the rates of interest for agriculturists.

Establishment of local banks with local knowledge.

(4) Some local banks have been started in important places. They inspire confidence in local people and are able to canvass business more easily. They make clean advances also to some extent as they have the requisite knowledge of the people of that locality.

Q. 133. Indicate the position of the joint stock banks in the Indian money market. Discuss how far they have been affected by the operations of the Imper al Bank of India.

(U. P. 1932)

Largest amount of capital, reserve and deposits.

A. **Position of the Joint Stock banks in the Indian money market.** The position of the joint stock banks is very important in the Indian money market. They have their offices in about 1200 towns of India. Whenever the word bank is used without any epithet, it means

joint stock bank. In fact, in number of offices, share capital, reserve and deposits, etc., they form the most important unit of the Indian money market. All these things have recently much increased. But there is a keen competition between these banks and exchange banks on the one hand and Imperial Bank on the other. They are looked upon as dangerous rivals by the indigenous bankers also. To quote the words from the report of the Central Banking Enquiry Committee, "Placed in this position they have been called the cinderella of the Indian banking system, and have only been able to exist amidst bickerings, suspicions and cut-throat competition."

Competition with indigenous bankers, exchange banks and Imperial Bank.

A number of cases have been experienced where a bank, after having established itself in some relatively small market and having secured such business as was available, found itself faced with the competition of a second bank which deprived it of a part of that business, and occasionally succeeded even in ousting it altogether. Such occurrences are very unfortunate. The country does not require competition but diffusion of banking facilities. Only big commercial centres require a number of banks.

Competition between themselves.

Diffusion and not competition is required.

There is another difficulty. Because of the numerous failures of joint stock banks in the past, they are not in a position to inspire confidence. Exchange banks and Imperial Bank have been successful in this respect to a very great extent. It is because of this fact also that they cannot withstand their competition.

They do not inspire confidence.

It was expected at the time of the establishment of the Imperial Bank of India that the

joint stock banks of the country would gain by it. This expectation has been partly realised. The standard laid down by the Imperial Bank of India is sufficiently high. This has led to *the improvement of their position by joint stock* banks also. Its establishment resulted in inspiring confidence as well in the joint stock banks as people thought that it would provide them with funds during the period of crisis. This was done in many cases, though there were complaints made against the bank to the effect that it showed favouritism to the banks of non-Indian origin. Imperial Bank was also prepared to rediscount the bills discounted with other banks. But this facility was not availed of by joint stock banks. Imperial Bank itself competes for their business with them and hence naturally they did not like to disclose their bill portfolio to it by rediscounting them. The Imperial Bank also did not lay down any standard for the bills it was prepared to rediscount, but did not rediscount them when presented for the purpose by saying that they did not come to the standard. Joint stock banks, have benefited, again, in so far as it provided for the first time in the country, for clearing arrangements in some of its branches. Even now, when the Reserve Bank of India has been established, it continues to provide this facility in such clearing towns as have no branch of the Reserve Bank. Of course it does this, as an agent to the premier bank.

Improvement in their standard.

Improvement in confidence also.

Competition with Imperial Bank in matters of Bill discounting.

Provision of clearing arrangements by I. B.

Conclusion.

From the above discussion, we can say that the establishment of the Imperial Bank improved the position of the joint stock banks to a very

great extent but in certain places it has become a formidable rival to them.

Q. 134. Discuss some of the causes which have militated against the development of joint stock banking in this country. What suggestions would you make to make banking more popular? (*U. P. 1937*)

A. This question can be easily answered with the help of the answer to Q. 13 .

*Q. 135. Indicate and account for the diffi. culties which the Indian joint stock banks are experiencing at the present time with regard to the employment of their funds.** (*U. P. 1938*)

A. **Introduction.** The Indian joint stock banks are experiencing considerable difficulties with regard to the employment of their funds at the present time. This is why they have lowered their rates of interest for various kinds of deposits. They, in fact, discourage them, This is due to various reasons.

Fall in the land value in recent years.

Causes of the difficulty in investment at the present time. First of all these banks, unlike the commercial banks in other countries, invest their funds in landed properties. Their value has recently fallen very rapidly and hence investment in them has become very much risky. The recent failure of Benares Bank Ltd., was due to this to a very great extent. It had lent on the security of the landed properties, and the result was that with a fall in their value, there was a fall in the value of the assests of the bank too. The Reserve Bank of India could

* The position has, however, much changed since the beginning of the present war.

not accommodate it as its weak position did not warrant this.

Fall in the prices of agricultural produce also.

Then, Indian joint stock banks finance agriculture through indigenous bankers. Most of them have recently opened their pay-offices in the important mandies. The price of the agricultural produce has at present fallen very heavily and there does not seem to be any arrest in the decline. Under such circumstances investment in them also appears to be considerably dangerous. The number of defaults has been increasing. This is not the case with only agricultural produce. The same is the case with the manufactures too. Industrial concerns require both block capital and working capital. Joint stock banks provided them with working capital, but they find that this has also frozen. The price of the manufactures of these concerns having fallen, they are not able to pay even principal what to say of the interest. Besides, most of their produce remains unsold and they cannot make the payment of their loans on due dates.

Fall in the prices of manufactures also.

Unsold stock.

Gold not pawned due to rise in prices and silver not acceptable as security.

They made advances on the security of precious metals. Due to the rise in the price of gold, people prefer to sell it rather than to pawn it. The case with silver is just the opposite. It has recently fallen much in value and there is a continuous fear of further fall in it.

Stock Exchange securities too not, fairing better.

Stock Exchange securities also are not fairing better. In fact, they cannot when trade and industry is depressing. The dividends declared by the industrial concerns have been falling low and they have their own effects upon the prices of the shares and debentures.

Q. 136. Discuss the nature of the business of the Joint Stock Banks in U. P.

Indicate their main difficulties at the present time. *(U. P. 1935)*

Receiving of deposits of various forms.

A. **Nature of their business.** Joint stock banks, first of all, receive deposits from people in places they have their offices. They receive deposits on fixed deposit, current and savings bank accounts. Central Bank of India had introduced a new kind of account, namely, home safe account wherein it provided the depositor with a small iron safe for depositing his daily savings. These were brought to the bank every now and then and the contents were received for credit of the depositor. It was designed to promote banking habit amongst children and was a sort of savings bank account. This account, however, did not prove to be very popular and hence is not in use now. The rate of interest allowed on fixed deposits varies according to time. Recently it has gone very low. Some of the banks allow interest on credit balances in current accounts as well provided it does not fall below a certain minimum. Use of cheques is allowed by some banks in savings bank account also.

Financing of trade.

They make advances and finance movement of both agricultural and industrial goods within the province, and as well as between this and other provinces. They have got their sub-agencies and pay offices in all the important mandis—*e. g.*, Hapur, Firozabad, Auraiya, Shikohabad, Deoband, Chandausi, Hathras, Kosi, Ghaziabad, Sitapur, Hardoi, Bindki, Debai, Ojhani, etc. At these places they make advances to the arhatiyas against the security of granaries. The amount so advanced

is sufficiently huge—in some places it being 10 and 15 lakhs of rupees annually. In fact, the amount collected on deposit of various kinds in big towns is utilised in making advances in these places. The income from this source is fairly large, and the branches having one or more of the above sub-agencies or pay offices attached to them fair better than branches without them. While the former are profit-giving branches, the latter mostly lose. But they have to be maintained in order to raise deposits and keep the dignity of the bank. *Advances of other kinds are made in* cities. Cash credit is of considerable importance. Overdraft is allowed to well-to-do customers. Loans are also granted on securities capable of easy realisation, *e. g.*, commercial paper and stock exchange securities. But all these commitments, are for small periods. Large commitments and those on the security of immovable property, are not undertaken. Personal loans are also not given. Most of the loans given in cities are meant to finance trade of both kinds. In some places, they also finance small scale industries. But this business is not very important.

Other kinds of loans.

Discounting business.

They discount bills and purchase hundis, though these are not very popular. They also issue drafts, letters of credit etc., make collection of debts for customers, receive and pay premium, etc., and keep jewelry and other valuables and documents deposited with them in safe custody.

Other businesses. Safe Custody.

Remittance business.

Remittance business undertaken by these banks is also of considerable importance. They buy and sell remittance at market rates. In some cases they vary from customer to customer. In places where they have to face competition with Imperial Bank, they charge the same rate as it does. In

other places, however, their charges are often higher. Usually 1/4 per cent. to 1/32 per cent. is the rate charged on such remittances—the rate being lower for larger amounts.

Difficulties. One of the main difficulties of these banks is that equitable mortgages are not allowed in U. P. Some of the laws of inheritance are also such as make it difficult to realise debts. They are not able to grant personal loans as they are not possessed of information regarding the customer's credit. There are no agencies to supply the same. Then, advances against goods are made when they are left at the disposal of the banks. In this country, there are no public warehouses, and goods in their absence cannot be left with the borrowers. In almost all places of importance, banks have got godowns. These are, however, not convenient for keeping all kinds of merchandise. The use of hundis and bills should also be popularised. The establishment of public warehouses will facilitate the distinction between a trade bill and finance bill. Joint stock banks can also take upto the finance of agricultural industry through co-operative societies and indigenous bankers. This would go a long way to increase their usefulness.

Defective laws.

Personal loans not possible.

Absence of public warehouses.

Use of bills should be popularised.

Financing of agriculture.

Q. 137. Discuss the causes of the failure of a large number of banks in India in the past.
(Allahabad, 1940)

A. **Causes of the failure of a large number of banks in India in the past.** First of all, a good number of banks have failed in this country due to the lax laws, public ignorance and bad or dishonest management. The manager

Lax laws, public ignorance and bad or

dishonest management.

of one of the banks, on his appointment to the said post pleaded ignorance of banking and accountancy and requested the Directors for a strong committee to assist him. Even up to the time of liquidation of this bank; he had not learnt anything, as he himself had then admitted.

Speculative activities.

Secondly, many of them have failed because of the entering into speculative activities of the bank officers.

Mixed banking.

Thirdly, many banks have failed because of their undertaking industrial finance out of banking funds. In fact, public opinion has been in this country overwhelmingly in favour of mixed banking such as prevails in Germany and Japan. But this is not possible here due to the fact that Indian banking system has been based more on the lines of English banking system whose characteristic feature is complete separation of commercial banking from industrial banking.

Antagonastic mass opinion against some.

Fourthly, many of the banks have failed because of the antagonastic mass opinion against them which had developed at one time or the other. They may, in fact, be regarded more as victims of misfortune than of anything else.

Lack of a central bank to help them.

Fifthly and finally, a number of banks failed in the past because of the lack of a central bank to help them in times of need. In case, a bank is solvent and has a good position, it is reasonable that the central bank of the country should help it on the basis of its assets The Reserve Bank of India, however, even after its establisment did not help Travancore National and Quilon Bank when the latter fell in difficulty. This was of course due to certain peculiar conditions,

and it is very necessary that something should be done to avoid them in future.

Q. 138. Mention the different kinds of banking services which Indian banks are able to offer their clients. Explain briefly how the services are helpful to the trader. (U. P. 1943)

A. An answer to this question can be given with the help of the answer to Q. 136.

APPENDICES

I

GROWTH OF JOINT STOCK BANKS IN INDIA

(In lakhs of Rupees)

	Capital	Reserve	Deposits
1880	18	3	63
1890	33	17	270
1900	82	45	807
1910	275	100	2565
1920	837	255	7114
1930	744[1]	440	6321[2]
1935	817	502	8444
1940	909	556	11398

[1] There was a gradual fall from 1922-28.
[2] There was a rapid fall in 1922 and 1923.

II

SUPPLEMENTARY QUESTION

Q. 1. Enumerate the functions of a bank. Give the importance of the Indian Joint Stock Banks in the banking system of our country. (*Rajputana*)

Please consult answers to Qs. 132 and 134.

CHAPTER XVIII

EXCHANGE BANKS

Q. 139. Explain briefly the method of settlement of trade accounts between India and foreign countries. In this connection bring out clearly the respective part played by (1) the Exchange Banks, and (2) the Government. *(U. P. 1933)*

A. **Method of settlement of trade accounts between India and foreign countries.*** Trade accounts between India and foreign countries are settled through bills. When goods are exported from this country, a D/A or D/P bill is drawn on the foreign importer or on some bank in London with which the foreign importer may have opened credit. It is either sold to or discounted with an exchange bank. The amount of the bills so drawn is usually in sterling and banks pay them in Indian currency according as is the current rate of exchange on that particular date. In the case of imports, importers are required to open a credit with some London banker. Here, again, these foreign banks come to their rescue. They, on receipt of a small percentage, arrange to get a credit opened with some bank in London. This having been done, the exporter draws a bill on the particular banker who on receipt of the delivery documents accepts it. These are then sent to India where the importer takes them up after making the payments. From the above, it becomes clear that exchange banks play an important part in the settlement of trade accounts between India and foreign countries. Payment for both our exports

Settlement through bills.

Export bills purchased by exchange banks.

Import bills accepted by London bankers on the recommendation of the exchange banks.

* This has changed, how ever, due to the present war.

and imports from and to foreign countries, even other than U. K. are settled through London. Foreign exchange banks both purchase and sell the right to sterling in London. The excess purchase or sale of one bank is made good by the corresponding excess purchase or sale of the other banks. Normally, India has a favourable balance of trade, and hence, there is an excess of sterling purchases. The Government of India has to remit annually sterling in connection with home charges. These she purchased directly from the exchange banks before the establishment of the Reserve Bank of India and since then through it.

Excess of exports purchased by Government to meet home charges.

In case, there was any excess still left with the exchange banks it could be handed over to the Government for investment in sterling securities in connection with the gold standard and paper currency reserves. If, on the other hand, there was a shortage of sterling with the banks they could purchase it from the Government. Since the establishment of the Reserve Bank of India, it is under obligation to purchase or sell sterling at fixed rates in sums of not less than £ 10,000.

Any further excess also purchased by Government and shortage supplied by it.

Responsibility shifted upon R. B.

Q. 140. What part do Indian banks play in financing the foreign trade of the country?

Analyze the elements of weakness in our banks in this connection.

How far can banking legislation help in this direction? (*U. P. 1935*)

A. **Financing of foreign trade.** The financing of foreign trade consists of two operations, ***viz.***, (1) the financing from the Indian port to the foreign port or ***vice versa***, and (2) the financing from or to the Indian port, to or from,

Two operations.

First wholly and second partially performed by exchange banks.

the up-country distributing or collecting centres. The whole of the first class of business and in some cases the second class of business also are in the hands of the foreign exchange banks. They have a number of branches in inland towns, and through them perform the second class of business too.

Imperial Bank and financing of foreign trade.

Before the amendment of the Imperial Bank of India Act in 1934, it was forbidden to undertake foreign exchange business. Other Indian banks could not and did not do this business in the teeth of opposition of the foreign exchange banks. Since 1934, Imperial Bank of India has been allowed to take up foreign exchange business, but it has not given any serious attention to it till now.

Part played by Indian banks in financing foreign trade.

The second class of business is, however, considerably financed by indigenous bankers, joint stock banks, and Imperial Bank of India. When goods are exported from collecting centres, merchants approach Indian banks for help. These have got their connection with one or the other of the foreign exchange banks and get the first class of business done through them.

Opening of branches outside India.

Elements of weakness. Indian banks must have branches outside India and specially in London, if they wish to undertake exchange business. But, it is very difficult to open and support a London or any other foreign branch. It requires a huge capital and it must be prepared for unforeseen losses. If import bills are drawn in rupees, Indian banks may take the advantage. But this necessitates the improvement in the bill and money market in the country.

Introduction of rupee import bills.

No help

Banking legislation. Banking legislation

cannot much help Indian banks with regard to the first class of business. This, they can take up only if they have got sufficient capital and can open a branch in London. Second class of business can however be monopolised by Indian banks, if the opening of branches of foreign exchange banks in inland towns is altogether forbidden. They have recently started the practice of getting some Indian banks also affiliated to them. This can be forbidden. Then, exchange banks enjoy a very advantageous position over Indian banks in so far as the former are not subject to the same rules as the latter. In case they are done so, some competition may be eliminated with them. The best that can be done is, however, to establish an Indian exchange bank with a huge capital.

regarding first kind of business.

Second class can be monopolised.

Affiliation may be forbidden

They must be subjected to the same rules as Indian banks

Establishment of an I. E. B

Q. 141. What is the nature of the business of the exchange banks? Indicate in this connection some of the reasons why foreign exchange banks enjoy an exclusive monopoly of exchange business in India.

Give in a concise form, your suggestions regarding the establishment of an Indian exchange bank. *(U. P. 1936)*

A. **The nature of the business of exchange banks**: The main business of the exchange banks is to finance the foreign trade of India. Export bills are either purchased by them or discounted. Import bills are, on the other hand, collected through them. Besides doing this business, they do every kind of banking business. They receive deposits, make advances, negotiate bills, and do agency business in the country. They also finance internal trade in several important centres—Delhi, Amritsar and

Financing of the foreign trade.

Oth[illegible] bank[illegible] busin[illegible]

Financing of

Import of bullion.

Cawnpore. They also finance imports of gold and silver bullion.

Indian banks have no foreign branches.

Reasons of exclusive monopoly of exchange business in their hands. The foreign exchange banks enjoy an exclusive monopoly of exchange business in India. Indian banks have never successfully competed with them in this respect. In fact, foreign exchange business cannot be undertaken without having a branch in foreign centres and specially London. It has, however, been found extremely difficult for these banks to establish branches at foreign centres owing to the following reasons :—

Large capital necessary.

(1) They must have a large capital to command credit in the money market of these centres. Imperial Bank of India which owns this and hence can command a good credit was forbidden to take up the business to any appreciable extent. Since the passing of the Amendment Act of 1934, however, it has been freed to do so, but unfortunately it has not given any serious attention to this kind of business.

Large floating resources not available.

(2) They must have large floating resources to allow a large turnover. This is not possible so long as banking habits do not appreciably develop in the country.

Loss in the beginning.

(3) The branches must be run at a loss for some time until they become self-supporting.

Opposition of exchange banks.

(4) The foreign exchange banks have their own organisation and show hostility to any scheme of the Indian banks for breaking up their monopoly.

Desirability of improvement of bill market.

An improvement in the bill and money market would go a long way to break up the monopoly of the exchange banks.

Suggestions regarding an Indian exchange bank. Various suggestions have been made for the establishment of a strong Indian exchange bank. It may be a State bank, or a joint stock bank, or a joint bank. Imperial Bank has been freed from the restriction against its doing exchange business, but it has so far not given any serious attention to it, as has already been observed. If, however, it would have done so, even then, perhaps, the position would not have improved, as with more than one-half of its shares in the hands of non-Indians, it could not be expected to work in the interests of Indians. The establishment of a State exchange bank is recommended because it is felt that the situation created by the monopoly of exchange banks requires the full resources and prestige of the State to be brought to bear upon it not only at the beginning but also for some time to come. It is, however, pointed out that it should be forbidden to encroach upon the sphere of the Indian joint stock banks. The directors of such a bank will surely be appointed by the Government. It will also be given the sole right to carry on Government foreign remittance business. As against this, it is said, that a shareholder's bank is more desirable for this purpose, because the State cannot and should not take up to this business so long as it has certain other more important businesses to look for and which it cannot look to, due to the shortage of funds. Besides, it is pointed out that the establishment of a State bank would check the Joint stock banks of the country to take up to this business even in future as they would feel that they would not be able to compete with it on the basis of equality. The establishment of Joint

If I. B. were to take up the business, position would not have improved.

A state exchange bank.

A shareholder's exchange bank.

Joint banks.

banks controlled by Indians and non-Indians belonging to the countries with which India trades, as equal partners, has also been recommended. The advocates of this scheme say that foreign trade being between two parties, it is opposed to the interests of both that one of them, either Indian or foreign, should dominate the finance of trade. According to them, co-operation of both the parties is very essential. Rupee capital of the Joint banks suggested would be supplied by Indians, their foreign capital by foreigners overseas; they would be under joint supervision and their profits would be divided among the partners. The scheme is quite good but its materialisation in these days of separatist tendencies and distrust seems to be impossible. Compulsory Indianisation of the Indian part of the existing exchange banks is also recommended. It may be brought about by threat of closing the doors of the country against these banks, if they do not agree to the proposal. A close examination of the above schemes, however, leads to this conclusion that a shareholder's exchange bank would be the best. Its capital might have to be subscribed to some extent by the Government in the beginning. It would also be necessary for the Government to patronise it and place restrictions on the present working of the exchange banks with a view to strengthen its position.

Joint banks not possible.

Indianisation of foreign exchange banks.

A share-holder's bank will be the best.

Q. 142. Explain clearly how the exchange banks finance the foreign trade of India. What criticism has been made with regard to their methods of business? (*U. P. 1937*)

Two divisions.

A. **Method of financing.** The financing of foreign trade of India can be divided into two parts (1) the financing of the movement of

goods from Indian ports to foreign ports and *vice-versa*, and (2) the financing of it from or to Indian ports to or from, the distributing or collecting centres in the interior of the country.

First part of the business an exclusive monopoly.

The first part of the business is monopolised by foreign exchange banks. The second part of it is, however, shared by Indian banks also. But, for some time past, the share of foreign exchange banks in the second part of the business has also been increasing. They have either opened their branches in the interior or amalgamated some of the important Indian banks in order to do this.

Share increasing in 2nd part too.

Financing of export.

With regard to the finance of this trade between Indian and foreign ports, we must look to both exports and imports separately. When goods are exported from this country a D/A or D/P bill is drawn on the foreign importer. In cases, however, where the exporter has no favourable reference of the foreign importer, a credit is required by the latter to be opened with one of the London bankers, and the exporter, draws a bill on the same instead of on the foreign importer. These bills are either sold to or discounted with foreign exchange banks. It must be noted here that our export bills are usually drawn in terms of sterling and its equivalent in Indian currency is paid by these banks to the exporters according as the current rate of exchange is quoted in the market. The fact that these bills are in terms of sterling facilitates their rediscounting in the London money market if there be any need of funds to the banks purchasing or discounting them.

Financing of imports.

When we import, either a D/P bill may be drawn upon us, or we may be asked to open a credit with one of the banks in London. In the

former case. we get the delivery documents on payment, while in the latter case, we get the documents, and the payment is made whenever it is due.

Both export and import bills drawn in terms of sterling.

These bills are also drawn in terms of sterling, and the latter, *i. e.*, the bills accepted by the London bankers are discounted in the London market. Usually Indians are asked to open a credit in London, as foreigners do not think it safe to draw upon them as exchange banks do not give favourable references of them. In order to open a credit with a London bank, we have to approach an exchange bank of that country. This, on receipt of a percentage of the amount for which credit is to be opened, makes an arrangement for the opening of the credit.

They do not give good references of Indian merchants.

Foreign merchants import on better terms.

From the above discussion, certain things become clear. First of all, both of our export and import bills are drawn mostly in terms of sterling. This makes it necessary that they should be rediscounted in London money market. Introduction of rupee bills will go a good deal forward to encourage the development of a bill market in this country. Next, Indian importers have to import on D/P terms or are required to open credit with some London bankers. This is due to the exchange banks not supplying good references of them. While we export on D/A terms, we import on D/P terms. For opening a credit in London, we have to deposit a percentage of the whole amount in advance. The terms given to foreign merchants doing import business in this country are usually better. They get goods on D/A terms and are enabled to open a credit in London without depositing any percentage with the exchange banks here. Thirdly, the documents attached to

the bills are sent to the offices of these merchants for examination while Indian importers are called to the bank offices to examine them. Re. the examination of documents.

There are certain other points of criticism with regard to their method. Miscellaneous complaints.

(1) It is said that these banks compel the importers to utilise the shipping services of their own nationality.

(2) They also insist on insurance with foreign insurance companies.

(3) They charge a penalty for the late completion of exchange contracts.

(4) They have not appointed Indians on responsible posts though they have been working in this country for long.

(5) They are opposed to the developing of exchange business by Indian banks and try to create difficulties before them.

(6) They have opened their branches in the interior of the country also and thus compete with other banks in other spheres too.

Q. 143. Explain briefly the nature of the business of the exchange banks in India. Point out the criticisms that have been levelled against them and suggest the lines of reform.

(*U. P. 1939*)

A. (The first and second parts of the question can be answered with the help of the answer to previous questions on this topic.)

Lines of reform. The policy of open door to foreign banks in India should be abandoned. Their regulation by the introduction of a system of licensing similar to that operating in various Licensing of foreign banks by R. B.

other countries such as Germany, Italy, Japan and Canada, will go a good deal to improve the conditions. Now that Reserve Bank of India has been established, all the different units of banking companies should be under its control, and this can only be done by licensing them. No foreign bank should be allowed to establish branches in India or continue doing business in the country without procuring a licence from the Reserve Bank of India. The licence should contain provisions for the supply of periodical reports showing separately their assets and liabilities in respect of their Indian business to the Reserve Bank of India. It should also make it compulsory for them to invest the money received on deposit from this country in the development of the Indian trade and industries. Indian depositors should have a prior claim upon the Indian assets of the banks which should not be allowed to be transferred to foreign countries. They should also be prohibited to purchase any Indian bank and open branches in the interior of the country. The staff of these banks should be required to consist of Indians—an exception may be made in the case of the manager.

Periodical reports.

Investment in India.

Prior claim of Indian depositors.

Prohibition to purchase Indian banks.

Indian staff.

Q. 144. Explain the nature of the business of Exchange Banks in India. What criticisms have been levelled against them? *(U. P. 1942)*

A. This question can be solved with the help of the answers to Qs. 141 and 142.

Q. 145. A of Calcutta has occasions to make payments from time to time to B of London. Sometimes he forwards B a sterling draft payable in London, and sometimes he accepts a bill in the currency drawn by B payable in Calcutta.

Indicate how the indebtedness between the two countries created by these transactions is utimately settled. (*U. P. 1943*)

A. **Settlement of indebtedness between India and England when a sterling draft is purchased in India or a bill is accepted payable in India.** When A purchases a bank draft ; he gives its equivalents in rupees to the bank issuing the draft and when B receives the draft he gets sterling in London. The result is that the bank in India becomes debtor to the Bank in London. But, banks in London also issue rupee drafts, and thus they become in their turn debtors to banks in India. Now, these debts and counter debts are set against one another and cancelled. If, however, there remains a balance it is sold to the Reserve Bank of India which is always prepared to do this business at fixed rates and in sums of not less than £10,000 at a time. Reserve Bank of India has got huge balances both in sterling and rupees. Besides, it has got an unlimited power to coin Indian currency. It can purchase sterling in England by selling its sterling securities.

Debts and counter debts are set against one another

Balance is purchased from or sold to the Reserve Bank.

Similarly when A accepts a Bill payable in India, and makes payment, the claim of the English bank upon the Indian bank is cleared by a counter claim of the latter upon the former.

APPENDICES

I

NAMES OF THE VARIOUS FOREIGN EXCHANGE BANKS CARRYING ON BUSINESS IN INDIA.

1. American Express Co.

2. Banco National Ultramarino.

3. Chartered Bank of India. Australia and China.

4. Comptoir National D'Escompte de Paris.

5. Eastern Bank Ltd.

6. Grindlay and Co.

7. Hongkong and Shanghai Banking Corporation.

8. Lloyds Bank Ltd.

9. Mercantile Bank of India Ltd.

10. National Bank of India Ltd.

11. National City Bank of New York.

12. Netherlands India Commercial Bank.

13. Netherlands Trading Society.

14. Thomas Cook and Son.

II

Supplementary Question

Q. 1. What is the nature of the business of the exchange banks? What criticisms have been levelled against them? Give suggestions for improvement.

(Please refer to the first part of the answer to Q. 141, the second part of the answer to Q. 142 and that to Q. 143.)

CHAPTER XIX

INDIGENOUS BANKING

Q. 146. Indicate the nature of banking business performed by the shroffs. What suggestions would you make to extend and popularise this business? *(U. P. 1931)*

A. **The nature of the banking business performed by shroffs.** Shroffs are of two kinds—small and kothiwal. The main business of a small shroff is that of a bullion broker. He executes orders for ornaments and advances gold or silver to goldsmiths. His banking business consists of discounting, rediscounting and dealing in hundis of all kinds. He also lends money on promissory notes and *sarkhats*, on mortgages of urban house property, and on the security of silver ornaments. One of his lines of business is the financing of small industries, *e. g.*, silk and brass in Benares. He occasionally receives small deposits.

Small and kothiwal shroffs.

Business of a small shroff.

The kothiwal shroffs handle all kinds of above business in large scales. They also finance the small shroffs. When in need of additional funds they rediscount the hundis in their portfolios with the banks. Landlords also look to them for loans on mortgages of the estates.

Business of a kothiwal shroff.

The business of the shroffs of both kinds is, however, now under decline. They are, therefore looking for fresh lines of business. Some

Declining tendency.

are acquiring real estates, while others are taking to commerce.

Receipt of deposits and dealing in hundis should be encouraged.

Suggestions to extend and popularise their business. These shroffs must begin accepting deposits. They should also use more and more of hundis in their dealings. This would provide for the automatic expansion and contraction of credit in accordance with the needs of the country. The use of hundis will also bring about co-ordination between them and a liasion with the modern banking. They may also combine and transform themselves into private limited liability companies. Fortunately, this tendendcy is fast developing in certain provinces of the country. In places where there is no branch of a joint stock bank, some of them may be asked to combine and become their agencies or branches on commandit principle. The joint stock bank would in such cases supply them with funds upto an agreed amount over and above their resources and local deposits and divide profits from that locality in a pre-arranged manner. In case of loss they would be held liable for the whole or a part. The lending bank, whilst retaining the advantage of limited liability would thus enlist the support of their local knowledge and experience. The Reserve Bank can also appoint them as its agent in places where there is no branch of a joint stock bank. They would surely come under control of the bank in such cases.

Their transformation into private limited companies.

Commandit principles.

Appointment as agent of R. B.

Taking up of bill broking business.

The business of bill-broking is very important in England. It can be taken up by the shroffs here in India. Borrowers unable to offer security would approach them for accep-

tance of their bills or hundis or opening of and guaranteeing commercial credit, etc. This would not only make them popular, and facilitate the availability of credit to people not able to reach the joint stock banks directly but also solve the difficulty experienced by the joint stock banks with regard to investment of their funds. Some of the big shroffs have adopted modern system of banking. Others may also do the same profitably. The Reserve Bank should provide facility of remittance to the shroffs on the fulfilment of certain conditions in the same way as it provides it to the joint stock banks.

Adoption of modern methods.

Provision of remittance facilities.

Q. 147. How do the indigenous bankers finance the inland trade of India? What suggestions would you make with a view to link up indigenous banking with the Imperial Bank of India and joint stock banks? *(U.P. 1932)*

A. **Financing of inland trade by the Indigenous bankers.** The indigenous bankers finance the inland trade of India to a very great extent. They enable both the agricultural and industrial products of the country to be brought to the market. Taking the internal trade in agricultural products first, broadly speaking, two methods are very prevalent. Firstly, the village cultivators sell their produce to the village money-lender who is also a trader and usually makes advances to the village cultivators at the time of sowing or afterwards. The village money-lender pays the cultivators in cash after deducting his advances. Then, he retains a part of the produce for local sale and sells the remainder to a town trader. This town trader is, again,

Village money-lender finances agricultural trade.

Money-lenders in towns also do it.

also a banker or money-lender. He, in his turn, distributes the surplus to neighbouring towns. At this point hundis are sometimes drawn on the purchaser and discounted. Secondly, there are *mandis* where more advanced village cultivators bring their produce directly. Here, there are town traders, agents of indigenous banking houses, and representatives of exporting firms, all ready to purchase with cash. Then, there is the trade of other goods. Petty retail shop-keepers obtain funds from local money-lenders to buy goods from bigger merchants in their own towns or other important mandis. As the goods are sold, the loans are paid off. Large merchants get goods from big trade centres through arhatiyas. These discount their hundis, and grant them book credits for the goods sent to them after being purchased from the wholesalers. The arhatiyas usually employ their own funds in the business but raise money by endorsing their customer's hundis and rediscounting them with the joint stock banks whenever they are short of it.

Financing of petty shop-keepers.

Financing of big merchants by arhatiyas.

A list of approved indigenous bankers.

Link between Indigenous bankers and joint stock banks and Imperial Bank. The joint stock banks' keep an approved list of indigenous bankers with whom they transact business, in the form of granting cash credits or discounting hundis or the bills drawn by their traders and endorsed by them. Every banker on the list is assigned a certain amount of credit, which is determined by his financial standing and beyond which as a rule, the banks do not discount the hundis or bills endorsed by him. In practice this limit is seldom exceeded, as the indigenous banker usually prefers to invest his own funds. It is only when he falls short of

Accommodation sought rarely.

these he approaches the banks. There is, however, difficulty with regard to the distinction of trade bills from finance bills. Emergence of documents of title to goods, *e. g.*, ware house receipts, etc., would improve the position. It is with this purpose in view that the establishment of licensed warehouses has been so often recommended. Greater use of hundis and their frequent discounting would go a long way to link the indigenous bankers with joint stock banks. They may also be made their agents in places where there is no sub-agency or branch of theirs to carry on banking business on their behalf. This would enable the indigenous bankers to receive funds from the joint stock banks. Profits will be shared between them in an agreed proportion. Losses, if any, may be borne up by the joint stock banks to a limited extent. They can also obtain better terms by combining themselves in the form of private limited companies.

Difficulty in distinguishing finance bills from trade bills.

Greater use of hundis desirable.

They may be appointed as agents.

Formation of private limited companies.

The relation between the indigenous bankers and the Imperial Bank of India is confined to granting facilities for remittance and financing them by discounting or rediscounting their bills and granting them advances in other ways similar to the lines followed by joint stock banks. The position can be improved by following the lines already suggested for linking them up with the joint stock banks. There is a great field for making them work in those places where it has no branch of its own or where there is no branch of any bank at all.

Their present relation with I. B. can also be improved.

Q. 148. Analyze some of the principal defects of indigenous banking in India. How far are

such defects likely to be remedied by the recent development of the Reserve Bank of India?*

(*U. P. 1936*)

Their business hardly constitutes banking.

A. **Princial defects.** One of the principal defects of indigenous banking in India is that their business hardly constitutes 'banking' as it is understood in the modern banking world. The indigenous bankers have comparatively little deposits and hence they do not deal appreciably in other people's money which is the unfailing characteristic of modern banking. The important effect of this is that the national savings of the country, in place of being conserved together as bank deposits and made available for developing the natural resources of the country, lie useless as hoards burried underground, or in the shape of ornaments.

They have not developed investment habit in the country.

Their main business money-lending is also defective.

The main business of theirs is money-lending. It also has certain concomitants, *e. g.*, usurious rates of interest, compound interest, dishonest dealings, lending for unproductive purposes, which result in misery of the debtors.

No discount market.

Another unfortunate feature of indigenous banking is that relating to the absence of a discount market. Trade and industry are financed under cash credit system and a large volume of actual currency is required. Its transfer and retransfer from one centre to another involves much expense and trouble. Besides, the small use of hundis means the absence of discount market, a most effective means of connecting them to the joint stock banks.

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*The question has been dealt with in the light of the working of the Reserve Bank of India as it has since then been established.

Then, the indigenous bankers neither control nor are controlled by the joint stock banking system in the country. There is no liaison between the two systems, and therefore, no effective leadership. The indigenous bankers work practically in individual units. It is only in busy seasons that they take advantage of accommodation which the joint stock banks are prepared to grant them. Hence bazar rates are independent of bank hundi rates. Due to the lack of unity, indigenous bankers keep their own reserve and joint stock banks, their own. In fact indigenous bankers need not keep any reserve as their liability is not a demand liability, and this can be brought about only if they begin to depend upon joint stock banks for accommodation. As the reserves are scattered, it is not easy to move them from a centre where they are in excess to a centre where they are in demand. The position with regard to the reserves may be summed up in two words --scattered and immobile.

Neither control nor are controlled by the modern banking system.

Bazar rates and hundi rates are independent.

Scattered and immobile resources

Effects of the establishment of the Reserve Bank. These defects have not been remedied to any extent by the development of the Reserve Bank of India. It has failed to bring them under its control. The open market policy of the Reserve Bank of India has not been successful for the simple reason that an open market has not come into being in the country. There are two markets–indigenous and modern. Indigenous market has got to do very little with the modern market. Mostly indigenous bankers, as has already been been, depend upon their own funds. They seek for accommodation from joint stock banks only during busy seasons. The in-

Reserve bank has not been able to bring them under control. Bazar rate is independent of the R. B.

digenous bankers do not use bills to any appreciable extent. The Reserve Bank of India circulated a scheme for linking of indigenous bankers with it. No action has, however, been taken in this respect so far. Unless and until something is done to place restrictions upon their business and get periodical information from them nothing can be done.

Scheme for meeting the situation under consideration.

Q. 149. What suggestions would you make with a view to make indigenous banking more popular and useful than it is at present?

(U. P. 1938)

A. **Suggestions to make it more popular.** Indigenous banking can be made more popular and useful than it is at present by removing all its defects. Firstly, the indigenous bankers do not receive deposits. They should do so, as the chief characteristic of modern banking is using other people's money, and unless they receive deposits they cannot do this. At present, they use only their own money. They ought also to provide cheap credit and that too, for mostly productive purposes. The indigenous bankers charge a very high rate of interest and compound interest. In fact, there is a greater demand for money than its supply, and consequently it is but natural that they charge high rates of interest. If they begin receiving deposits, they shall be able to lower their rate of interest. They can do this also if they are enabled to receive funds from joint stock banks. These days, they have got a surplus of it. Besides, they can obtain any amount of it from the Reserve Bank of India on the basis of commercial papers. For this purpose, it is necessary

Receipt of deposits.

Loans should be supplied at cheap rates and mainly for productive purposes.

Should depend more

that indigenous bankers should seek more of accommodation from them. At present, they seek for it only during busy season. And in order to seek for more accommodation from the joint stock banks, they shall have to use more of bills or hundis in their dealings with their borrowers than they do at present. Most of the dealings of the indigenous bankers is now on cash credit basis. This ought to be substituted for by bill accepting and discounting. The use of hundis has been in vogue from times immemorial in this country but it has generally been restricted only to the transfer of money. Its use for manufacturing credit has been very little. In order to encourage it stamp duties on these shall have to be reduced.* The language of the hundi is far from being simple. It shall have to be simplified. In case printed hundi forms are made available in each post office, the advantage may be taken of by the public.

upon J. S. banks and R. B for accommodation.

For this, use of bills and hundis is desirable

Reduced stamp duty Simplification of language.

Supply of printed hundi forms.

The indigenous bankers shall transform themselves into limited liability companies. Those whose business is very limited may combine with advantage. Country bankers of England did this and banking has been consolidated in that country. The same can be done here. The different owners may act as directors and managers in the combined businesses. They should also form District Associations, Provincial Associations and an All-India Association so that they may be able to make their voice heard. At present the opinion of the people is very much biased against them. In order to create an

Their consolidation necessary.

Formation of Associations.

*Since this was written, stamp duty has been reduced.

Stoppage of various malpractices. **Modern methods.** **Extending their business.**

atmosphere favourable to themselves, they ought also to stop the various mal-practices adopted by them. Indigenous bankers would do well to take up to the modern methods of banking. Some of them have already done so. They allow the use of cheques to their customers and issue pass books. Others may also follow them. They can also increase their business by beginning to undertake all those kinds of business which the joint stock banks undertake.

Their appointment as agents.

Reserve Bank of India should appoint them as its agent in places where there is no branch of Imperial Bank or a joint stock bank on the fulfilment of certain conditions. Joint stock banks may also give them their agency on Commandit Principle.

Q. 150. Describe breifly the functions of indigenous bankers. Point out the criticisms that have been levelled against them. Suggest remedies to remove those defects. (*U. P. 1942*)

A. This question can be solved with the help of the previous questions.

Q. 151. Attempt a critical note on the problem of linking the indigenous bankers with the Reserve Bank of India. (*Calcutta, 1938*)

C. B. E. C. showed the necessity.

A. **The problem of linking the indigenous bankers with the Reserve Bank of India.** The Central Banking Enquiry Committee showed the necessity of linking the indigenous bankers with the Reserve Bank of India, and for this purpose it laid down certain conditions which must be fulfilled by them before being eligible for it. The Reserve Bank

R. B. has been established

of India has, however, been established, but nothing has been done so far to link them to it. The Section 55 (1) of the Reserve Bank of India Act.

prescribed that "the Bank shall, at the earliest practicable date and in any case within three years from the date on which this chapter comes into force (*i. e.*, on or before the 31st December, 1937), make to the Governor-General in Council a report with proposals if it thinks fit on the following matters, namely :—

Obligation upon R. B. in this respect.

(*a*) The extension of the provisions of this Act relating to scheduled banks to persons and firms, not being scheduled banks engaged in British India on the business of banking, and

(*b*) The improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enterprise and the operations of the bank."

Part (*a*) refers to indigenous bankers but to the extent they finance the movement of crops and also provide credit directly and indirectly to agriculturists, they are an agency for supplying agricultural finance, and thus the question of their improvement and the co-ordination of their activities with the Reserve Bank is also partly included in part (*b*) of the terms as well and hence the two terms were inter-connected.

Preliminary and Statutory Reports of the Reserve Bank.

The bank in fulfilment of the above requirement released what are known as a Preliminary Report and a Statutory Report in December, 1936 and 1937 respectively. The two reports may be regarded as complementary and covered much ground. As a step towards controlling the rates of interest and the money-lenders' methods of business they suggested legislation for the regulation of the business of money-lending and some of the Acts in this connection enacted since then were based on the suggestions contained therein.

Concrete proposals were also made to the representatives of indigenous bankers and others with a view to link them to the Reserve Bank of India. They were, however, not new and were based on the recommendations of the Central Banking Enquiry Committee. Very briefly they suggested that if the indigenous bankers were to come into practical relationship with it, they will have to formalise their methods of business on lines approximating to joint stock banks, and in particular, develop the deposit side of banking activities. From the replies received thereto, it may be concluded that they all disagreed with the suggestions regarding the taking of deposits and giving due publicity to accounts. There was no doubt, agreement on various other points, *e.g.*, the maintenance of accounts in approved form and giving up of speculative business. They were also not prepared to confine themselves to banking business only. They felt that in some cases the stoppage of a non-banking ancestral position would invalue not only the closing of a lucrative source of income, but might be below to the prestige of the indigenous bankers concerned in their locality. This seems to be truly speaking a correct view. It may also be said that there seems to be no valid ground for the insistence of the Reserve Bank of India on the indigenous bankers' receiving deposits when they perform many of the other banking functions. In fact, we do not understand why should so much stress be laid out only on this function on the lines of the English banking system. Can India not follow the system it has evolved after an experience of centuries? The indigenous bankers themselves are anxious to take a leading place as bankers in the life of the

Proposals for linking indigenous bankers to the R. B.

Formality in business.

Deposit business.

Views of Indigenous bankers.

Insistence on receipt of deposits not necessary.

country, as important as they had in the past. The difficulty arises, however, because of the different view taken by those who are the masters of the destiny of the country. In fact, they being alien cannot be impressed with what is indigenous and must regard their own methods and agencies useful. The attitude of the bank must change with regard to this question. It is, however, very necessary that the indigenous bankers too must change their methods of business with a change in the time, and attain a standard worthy of the membership of a central bank.

They must improve the standard.

There is, however, one more suggestion mentioned in the Statutory Report, and this may result in ultimately bringing the indigenous bankers in direct relationship with it without compelling them even in the least to modify the essential character of their business or to submit to unduly rigid restrictions. We already know that they have been accustomed to the use of hundis for long. In case they augment it, a bill market can be developed in this country. The bank has promised to extend its open market operations to hundis also, and this would surely bring at least the important ones in close touch with it. So far, the stamp duty on these instruments had been on a scale which made any augmentation in their use impossible, but since 1940, it has been reduced and now at least one of the impediments to it has been done away with.

Development of a bill market.

Q. 152. What is the difference between a modern bank and an indigenous bankers? Enumerate the kind of business that the latter transacts. *(Rajputana Board)*

A. **Difference between a modern bank**

and an indigenous banker. A modern bank is quite different from an indigenous banker as is evident from the following :—(1) While a modern bank deals to a very great extent in other people's money, an indigenous banker mostly deals in his own money. This is quite clear from the fact that while the former receives deposits from the public, the latter rarely does so. As a result of this, we may say that while the former encourages thrift and develops investment habits of the people, the latter does not do anything of the kind. (2) While withdrawals from a modern bank do generally take the form of cheques, those from an indigenous banker do usually take the form of cash. From this, it may be concluded that while the former creates credit money, the latter does not do so at all. (3) While a modern bank confines its business only to banking, an indigenous banker combines it with trading and other businesses also. (4) While a modern bank advances money only on what are known as easily realisable securities, an indigenous banker advances it also on immovable property. Then, almost all the loans of a modern bank are secured, but as against this, quite a large number of those of an indigenous banker are unsecured. Further, while a modern bank grants loans generally for a short period and productive purposes, an indigenous banker does so also for a considerable long period and unproductive purposes. (5) While a modern bank charges low rates of interest, an indigenous banker's rates of interest are exhorbitant. The latter is rapacious and noted for his usury and other malpractices. (6) While the methods of business of a modern bank are the most up-to-date, those

Encouragement of deposit business by a modern bank.

Withdrawals by cheques in the case of a modern bank.

A modern bank confines to banking business only.

It advances only on the basis of easily realisable securities, and for short periods, and productive purposes.

It charges low rates of interest.

of an indigenous banker are much antiquated. As a corollary to this, it may be said that while the establishment charges of the former are very nigh, those of the latter are considerably low. Again, there is a vast difference between the dealings of the two. It is perhaps due to the fact that while the clients of an indigenous banker are mostly his own neighbours belonging to his own kith and kin, those of the latter are quite unfamiliar to him. In many of the modern banks, we have got European managers who do not follow even the language of many of their clients, what to say of being familiar to them, and establishing a personal touch with them. (7) While the clients of an indigenous banker need feel obliged to him for granting the loans, those of a modern bank have not got to do anything like that. The relation between the latter is nothing but of equality. (8) While indigenous banking takes mostly the form of an individual concern, modern banking usually takes the form of a joint stock company. Again, while an indigenous banker scarcely has any branches or at the most only a few, a modern bank has generally a number of branches. Further, the number of the former is very huge, but that of the latter is very limited. Finally, the former have no organisation of their own, but the latter have important organizations.

It adopts up to-date methods.

Establishment charges low.

Clients unfamiliar.

Relation of a equality with the clients.

Joint stock form of proprietorship.

Branch banking.

Modern banks have organisations.

Kinds of businesses transacted by an indigenous banker. An indigenous banker transacts very useful banking businesses. He plays a very predominant part in financing agriculture, internal trade and small cottage industries. About 90% of this business is in his hands. This involves buying and selling remittance, discounting

Finances agriculture, internal trade and small cottage industries.

Remittance, discounting and loaning businesses. hundis, and advancing loans against stock in trade. He finances internal trade by granting cash credits and advancing on the security of the produce. Hundis too are discounted, if any. **Supplies raw material.** He finances artisans by supplying them with raw material or money for the purchase of the same. **Consumption loans.** Finally, all the consumption loans are mostly provided by him.

Q. 153. Describe the indigenous banking system of India. What measures would you advocate to co-ordinate the same with the modern banking system prevalent in the cities. *(Allahabad, 1941)*

A. **A description of the indigenous banking system of India.** The word 'indigenous' meaning 'native' born or 'produced naturally in a country', **This term is applicable only to a system of dealing in money evolved in this very country.** the term indigenous banking may be applied to a system of dealing in money evolved in this very country. This may be taken to mean the system of banking in contrast to alien or foreign which comprises of modern banking. From this, it follows that the people doing business on the lines of English system of banking though belonging to this country cannot be called indigenous bankers. The term can be applied only to such as have been doing business on purely Indian system. Now, this we must remember **This system does not make any distinction between money-lending and banking.** does not make any distinction between money-lending and banking. Efforts have, however, been made by modern Indian writers to distinguish one from the other, but the result has been a complete failure. If in spite of this we insist upon differentiating between the two, we may say as Dr. Jain has said that 'In common usage in India, the distinction between them is generally based on

the working capital.' In case it is small, it is money-lending and in case it is big it is banking.

Money-lending. Money-lending pure and simple means the business of lending money. This is practised both in villages and towns. In villages, there are banias and mahajans only and in towns there are besides these sahukars, shroffs or sarrafs and kothiwals. Banias. The banias belong to different castes and deal usually in grains and provisions. They lend both in the form of money and kind. Mahajans. The mahajans are also akin to banias with the only exception that they command a higher prestige than the latter. A sahukar. A sahukar is also equivalent to a mahajan, though as compared with him he is usually a financial magnate. He advances money on land mortgages as well. A shroff or sarraf. The shroff or sarraf is primarily a bullion dealer. Besides lending money, he also deals in hundis and sometimes receives small deposits too. All these functions may also be performed by wholesale grain, ghee, sugar, cloth and other dealers. A kothiwal. The kothiwal is usually a zamindar or business and industrial magnate performing the more important of banking functions. Itinerant peripatetic money-lenders. In addition to the above fixed or stationary money-lenders, there are also what may be known as itinerant peripatetic money-lenders, who go by the names of quistias, rahtiwalas, ugahiwalas, hundiwalas, kabulis, harhiyas, beoparis, banjaras, behwaris, pheriwalas, khandsalis and, chettis, etc. A mateur monsy-lenders. Over and above the professional, money-lenders described so far, there are a number of amateur money-lenders as well.

The methods of the business of the money-lenders are very cheap and simple. The establishment is neither costly nor imposing. The methods

Methods of business, etc.

of accounts too are very simple though, at the same time accurate and efficient. There are various systems of money-lending. The following are, however, very common :—money-lending on the basis of a promissory note, or a raseed, or a dastavez or a ticket bahi. Then, it may also be on the basis of kist or rujahi. From the point of view of security, it may be hatudhar, or girvin or rahan.

Other banking activities.

Some of the indigenous bankers besides lending money also carry on other banking activities. They finance agriculture indirectly. In fact, it is not practicable for them to establish direct relations with the peasants as they live mostly in urban areas. Hence, they catch hold of the money-lenders and traders who receive accommodation from them and bring the crop produce in its stead.

Financing of agriculture.

In recent years, they have begun taking interest in mill industries as well. Quite an appreciable number is being run under their management.

Interest in mill industries as well.

As far as the financing of cottage industries is concerned, it has, however, been from the beginning mainly in their hands. As a rule, the artisan has a very small capital of his own. The money-lenders and indigenous bankers supply him with the raw material and generally make it obligatory upon him to sell the entire product to them at a price which is considerably lower than what it ought to be.

Financing of cottage industries.

Further, agricultural products are brought to the market by their assistance. They help the distribution of other goods also. These people do not act only as commission agents and keep the goods on behalf of others by paying for them for the time being, but also enable the actual sellers and purchasers in transferring money from one place to another by

Marketing finance.

issuing demand hundis or discounting them. They receive very little of deposits, however, from the public. When they do it, it is mostly with a view to oblige friends. Inter-borrowing is of course very common.

Remittance business.

Deposit business not important.

Measures to be taken for co-ordinating the above with the modern banking system prevalent in the cities. First of all, indigenous bankers should be linked with the Reserve Bank of India, the premier bank of the country. Such a link will surely result in the co-ordination of the activities in the two markets, *viz.*, indigenous money market and the modern money market which exist in the country. This will also result in the raising of the standard and improving of the activities of the indigenous bankers. Then, they have in recent years lost the deposits they had in past years. Whatever might have been the reasons for the weakening of the old system, linking is expected to encourage more deposits being withdrawn towards them. Next, banking business of the indigenous bankers will also increase as a result of this relationship and hence they may be able to shed their non-banking business gradually. Another advantage will be that they will become eligible for obtaining loans and advances and discount facilities from the Reserve Bank. Finally, it will also offer them remittance facilities.

Linking of the Indigenous bankers with the Reserve Bank and its advantages.

Their relationship with the Imperial Bank and other commercial banks should also be improved. The latter maintain, at present, an approved list of the former, and continue their dealings with only such of them as are mentioned therein. This is really a very serious defect of Indian

Relationship with the I. B. and other commercial banks also needs improvement.

banking system and has resulted in the segregation of the two important credit agencies whose co-ordination would be of the utmost benefit for trade and industry of the country. Even in the case of the indigenous bankers included in the approved list, it may be said that these banks do not do much for them as well. They are given discounting facilities, but in the majority of cases accommodation is sought occasionally, as it is not made available to the extent of the requirement. In fact, a prescribed limit is placed against the name of the particular party in the approved list and this cannot be exceeded at any time whatsoever. They are in short treated just like ordinary customers.

Conclusion.

In conclusion it may be said that the position is not at all satisfactory, and efforts must be made by all the parties concerned to improve it.

Q. 154. Give a brief outline of the Sahukari or Mahajani System in any locality with which you may be familiar. Comment upon its usefulness and otherwise. (*U. P. 1933*)

Financing of agricultural trade in important mandies.

A. **Description of Sahukari business in and near about Allahabad.** There are a number of important mandis near about Allahabad—the important ones are those at Sirsa, Rajapur, Jasra, Bharwari and Khaga, etc. There are some very respectable mahajans at Sirsa and Rajapur. They collect grains from the neighbouring villages and pay hard cash. Then, they hold stock either on their own behalf or on that of their customers and send it to far off places like Calcutta and Bombay. The Imperial Bank of India accommodates them at Rajapur, and other banks at other places. These banks invest a good deal of

money at these places, on the basis of hundis, cash credits and over drafts. The mahajans at places where there are no banks have to depend mostly upon their own selves. The modern banks do not accommodate them to any appreciable extent. It is obvious from this description of the business done by these mahajans that they render valuable services to the agricultural industry and trade. Besides, they also grant loans to neighbouring people—some of whom are petty mahajans and others are consumers themselves including the cultivators. They do not receive deposits.

Their condition at Allahabad.

Coming to Allahabad city itself, there are zamindars, grain-dealers, ghee and sugar merchants and shroffs doing the mahajani business. No doubt, many have given it up due to evil days and others are simply lingering on against competition with the Imperial Bank and other joint-stock banks. Use of hundis for remittance purposes has receded to the back-ground. Joint stock banks charge one anna per cent for issuing draft while these indigenous bankers do it at not less than two annas per cent. Most of them have also closed their branches and given up connections at other places. They were formerly necessary but now modern banks afford every facility. If, however, they hold hundis on other accounts, they sell it to those who wish to remit money. Mostly, they sell it to modern banks.

A description of hundi business.

Hundis generally arise either out of a purchase or sale on commission basis or for financing purposes. People place orders for purchase on their behalf and undertake to pay in part by means of hundis immediately. The balance is realised on delivery. These hundis are sent to

bank for collection. People write hundis upon their own selves also and give it to some mahajan for its present worth. The difference between the face value and present worth is known as batta. The mahajan sells it to modern banks, if and when he needs accommodation. Thus we see that the mahajani business plays a very important part even these days in purchase and sale of goods and in financing the people having credit in the market.

Money-lending business.

The mahajans grant loans of other kinds as well. They may be on the basis of a sarkhat, or jewellery pawned with them. In many cases, they are simply personal loans. They do not encourage deposits with them. It is, in fact, by way of obligation that they receive it. Many of the widows of Hindu families have their money with these mahajans who give 6% interest. But, this they do, perhaps, to help them. No doubt, there are many sahukars who would welcome such deposits but they are not trustworthy.

Absence of deposit business.

Q. 155. Show the inter-connection between the indigenous system of banking and the modern joint stock banks with special reference to any commercial centre in U. P. (*U. P. 1933*)

A. [An answer to this question can be given with the help of the answer to Q. 154.]

APPENDIX

SUPPLEMENTARY QUESTIONS

Q. 1. What do you mean by the term Indigenous Banker ? Briefly explain the part played

by him in financing trade and industries of India.
(*Rajputana*)

(Sufficient information is available in the answers to previous questions on this topic to enable the students to solve this particular question.)

Q. 2. What is the difference between a modern bank and an indigenous banker? Enumerat all kinds of business that the latter transacts.)

(The students are referred to the answers of the previous questions on this topic.)

CHAPTER XX

CREDIT CO-OPERATIVE ORGANISTATION

Q. 156. Describe briefly the constitution, functions and advantages of a co-operative credit society. How does it secure its loanable funds? How is it helped in this matter by the central co-operative agencies? (*U. P. 1939*)

Rural and urban.

A. **Constitution.** A co-operative credit society may be rural or urban. If rural, it is organised on the Raiffeisen model, and if urban, on the Schulze-Delitzsch model. The main features of a rural co-operative credit society are limited area of operation, lack of share capital, unlimited liability, non-issue of loans to non-members and for unproductive purposes, indivisibility of profits and honorary management. The urban co-operative credit society has just the opposite features, *viz.*, a wide area of operation, existence of capital, limited liability short term loans, divisibility of profits and paid management.

An association of 10 or more persons.

Distinction between the two kinds of societies.

Management.

A co-operative credit society is a voluntary association of ten or more persons living in the same village or town or of the same tribe or caste. If the four-fifths of the members are agriculturists, it is rural, otherwise urban. Rural societies and urban societies are known by the terms limited and unlimited liability societies respectively since the passing of the 1912 Act. All the members of such societies form their respective general bodies. An executive is also elected by the mem-

bers from amongst themselves. The society may have a small share capital subscribed by the members or only depositors. Entrance fees are also required to be paid by them in some cases. The management is carried on democratic basis—each member having one vote irrespective of the number of shares held or the amount of deposits made by him. The society maintains a list of the properties of its members known as Haisiyatnama and loans are granted in accordance with it.

Funds. Democratic basis. Haisiyatnama.

Functions. The functions of co-operative credit societies are to provide the members with cheap and easy but controlled credit, and to teach them the causes of sufferings in matters of credit and thereby to show them as to how they can themselves become self-dependent for all the ordinary needs of production by the exercise of thrift, self-denial and methods of business.

Provision of cheap and easy but controlled credit. Teaching the lesson of self-dependency.

Advantages. The advantages secured from them are of diverse nature. First of all, they provide facility of credit and are a cure of indebtedness. In our own country, they have, besides cheapning credit to their members, also compelled the money-lenders to reduce their rates of interest for fear of being ousted out altogether. They also improve the character of their members and inculcate in them such virtues as punctuality, thrift and self-help. Much of litigation which results in a drain of time, energy and money of the poor, is stopped, and disputes are settled by arbitration. As men of loose character and doubtful morality are not allowed to become members of the society, moral degradation of

Provision of facility of credit and cure of indebtedness. Improvement in character. Litigation is avoided. Correction of moral degradation.

the people is corrected to some extent. Then, they have their educative and administrative values. A member of the society attends its meetings, and understands its rules and regulations. This provides him with a civic sense which will go a long way to make democracy successful in the country. Finally, the principle of unlimited liability calls for mutual vigilance. Extravagance on ceremonial occasions is held in check. As a part of the profits is required to be spent for charitable purposes, they have brought about improvement in drainage system, digging of wells, provision of medical relief etc.

Educative and administrative values.

Exercise of mutual vigilance.

Various other improvements.

Funds. It has been seen that the members subscribe to the shares, make deposits and pay entrance fees. These provide for their finance. They secure loans from central co-operative banks as well with whom they are ultimately federated. Governments also grant them loans. Finally, they maintain a reserve fund out of their profits. This is very helpful to them. The central bank grants them loan to the extent of twice the value of the total Haisiyatnama of the members. The interest charged ordinarily is 12% and the loan is made on the joint responsibility of all the members.

Shares, deposits and entrance fees.

Loans from Central co-operative banks.

State help Reserve Fund.

Joint responsibility.

Q. 157. Describe the constitution and functions of Primary Co-operative Credit Societies. (Rural)

To what degree have they helped the peasant in the province? Suggest means of further improvements. (U. P. 1934)

A. [For answer to the 1st part of the question please look to the answer to Q. 156.]

Conditions in U. P. U. P. is very backward with regard to co-operation. Its number comes twelfth with regard to number of societies per 1 lakh inhabitants amongst all the provinces of the country—it being 16·6 per 1 lakh inhabitants. From the point of view of number, it is fourth with 8337 societies. In total number of members it stands fifth with 260,908 members and 15th with regard to number of members per 1,000 inhabitants. It being 5·2. Its total working capital is Rs. 257 lakhs, and 8 annas per head of population. These figures are for the year 1936-37.

Statistical informations.

Inspite of the backwardness of the movement in the province, it has helped the peasants a good deal. A large amount of capital has been provided to them at reasonable rates of interest. This is an organisation which can go a good deal to relieve the cultivator of that burden of usury which he has borne so patiently throughout the ages. Where the co-operation is strongly established, there has been a general lowering of the rate of interest charged by the money-lender. In fact, his hold has every-where been loosened due to the fear of the opening of a society. It has taught thrift to the extravagant and improvident people. Besides, they get the training of managing their own affairs.

A promising future.

Reduction in rate of interest.

Money-lender's hold loosened.

Teaching of thrift, etc.

Suggestion for improvement. Various suggestions have been made for their improvement. First of all, this movement in India has been an official movement. The aim of co-operation being self-help, de-officialisation of the movement is very necessary. But so long as a reliable public body does not take up the work, Govern-

Necessity of de-officialisation.

ment control seems to be necessary. Patient and persistent education in the meaning and principles of co-operation is very necessary to be given to the members of the primary co-operative societies. This can be possible only by having a well-trained staff Then, there is a complaint to the effect that over-dues have been accumulating. To avoid this a careful scrutiny of the purpose of the loan must be made every time it is granted. Audit, supervision, and inspection of societies should also be very thorough and for this purpose District Unions may be formed. Delay in granting loans to members should be, as far as possible, avoided. In fact, much depends upon the staff and hence a good training and selection of the same is a keynote to success.

Training in the principles.

Unproductive loans should be discouraged.

Audit etc.

Delay in granting loans.

Conclusion.

Q. 158. What conditions in your opinion are essential for the success of co-operative credit societies in India? What are the sources from which primary credit societies secure their finances? (*U. P. 1941*)

A. **Conditions essential for the success of co-operative credit societies in India.** Answer to Q. 157 under the heading: Suggestions for improvement.

Sources from which primary credit societies secure their finances. Answer to Q. 156 heading funds.

Q. 159. Describe briefly the working of a primary credit society in India. What are its advantages to the agriculturists? (*Rajputana*)

A. **Working of a primary credit society in India.** All the members of a primary credit society, whose number cannot be less than ten

form a general body, and elect from amongst themselves the office-bearers who form the executive. The number of the members and the area of operation of these societies are as far as possible kept very much limited with a view to avoid a deterioration in efficiency. The liability of the members is unlimited unless an exception is granted by the Government. The society obtains the working capital in the shape of entrance fees, deposit by members and surplus in the form of a reserve fund. It may also have its share capital These are supplemented by loans and deposits from other societies, from Government and from Central and Provincial Co-operative Banks.

A general body and an executive.

Number of members and area of operation limited.

Working capital.

The society maintains a list of the properties of its members known as Haisiyatnama and loans are granted to them in accordance with it. Whenever a member wants a loan, he puts in an application to this effect before the executive which decides each case on its own merits. No member can get a loan for a larger amount than what is justified by the records in the Haisiyatnama. These loans are granted only for productive purposes, all decisions being arrived at strictly on democratic lines. One member has only one vote in spite of the number of shares he may have. The members of the executive are not entitled to any remuneration, and the whole work is carried on honorarily. Debts are to be repaid in easy instalments, which coincide with the harvesting time. A great stress is laid upon punctuality.

Haislatnama and its use.

Process to be undergone in granting a loan.

One member one vote.

No remuneration for work.

Repayment in instalments.

In the absence of a share capital, the entire profit is carried to the reserve fund. But where there is share capital, a part is allowed to be

Allocation of profits.

distributed as dividend. A fraction of the total net profit is also required to be spent for charitable purposes.

Supervision.

The working of the society is subject to strict supervision. There is a large staff under each provincial registrar for this work.

Facility of credit and cure of indebtedness. Improvement in character. Educative and administrative values. Extravagance checked.

Advantages to agriculturists. The advantages of these societies to agriculturists are many. First of all, they provide facility of credit and are a cure of indebtedness. Then, they improve the character of their members and inculcate in them such virtues as punctuality, thrift and self-help. They have also got their educative and administrative values inasmuch as members attend meetings, study the rules and manage the societies. Finally, the principle of unlimited liability calls for mutual vigilance which fact alone holds much extravagant expenditure in cheque.

Q. 160. Briefly explain the functions of the Co-operative Credit Societies. (U. P. 1941)

A. This question can be solved with the help of the previous questions on this topic.

Q. 161. Carefully describe the constitution and functions of a Primary Credit Society in India.

(U. P. 1943)

A. For an answer to this Q., please look to the answers to previous questions on this topic.

APPENDIX

SUPPLEMENTARY QUESTION

1. Distinguish indigenous, co-operative and joint stock banks from one another so as to bring out their peculiar features in relation to aims, constitution and working.

(Punjab, B. A.)

(The students are referred to the previous three chapters.)

CHAPTER XXI

IMPERIAL BANK OF INDIA

Q. 162. Examine the position of the Imperial Bank of India in the Indian money market with reference to its relation to the Reserve Bank of India. *(U. P. 1940)*

A. **Position of the Imperial Bank of India in the Indian money market.** The position of the Imperial Bank of India is supreme in the money market of this country. It has the largest number of branches, the biggest amounts of capital and deposits. It is the sole agent of the Reserve Bank of India in all places in British India where, at the commencement of the Reserve Bank Act, there was a branch of the Imperial Bank and no branch of the Reserve Bank. It is because of this special relation of the Imperial Bank with the Reserve Bank of India that it has secured certain concessions from it, and the joint stock banks regard it as an unfair competitor. Before the establishment of the Reserve Bank of India, it had, however, even more concessions granted by the Government of India, because of its position as a central bank of the country. In fact, neither before the establishment of the Reserve Bank of India, nor after it, the Imperial Bank of India has ever been regarded as a friendly supporter of the joint stock banks, and there has never been any close connection between it and them. It does the same kinds of business as the joint-stock banks do. It receives deposits from

Max. branches, deposit, and capital.

The sole agent of R. B.

Enjoys certain concessions.

Competition with other banks.

the public and gives interest on them. Imperial Bank of India has, however, never given any interest on current account deposits, though it is allowed by certain joint stock banks. But, in spite of this fact it has the largest amount of deposit on current account also. This is perhaps due to the confidence it inspires because of its special relations formerly with the Government of India, and now with the Reserve Bank of India, and also due to its having the largest number of branches in the country. A bank, having larger number of branches, proves to be more useful to its cutomers for the transference and collection of money, etc., than any other bank. There were certain restrictions placed upon the kinds of business it could do by the Imperial Bank Act of 1920 but they have now been, since the establishment of the Reserve Bank, either slackened or removed altogether. It is, now, free to buy and sell foreign bills of exchange of usance not exceeding 9 months, if they relate to the financing of seasonal agricultural operations, and 6 months in other cases. It can also open cash credits, receive deposits and borrow money outside India. It can, again, make advances against goods hypothecated to it instead of being restricted to advances only against goods, which are in its possession or the documents of title which were deposited with it. Besides, it can make advances and open cash credits on the security of the shares of the Reserve Bank of India, or of debentures issued under the authority of the Municipal Board or Committee, or with the sanction of the Governor-General in Council or of debentures issued under the authority of the ruler of an Indian State, or

Inspires sufficient confidence.

Very useful to its customers.

Removal of certain restrictions or slackening of others.

subject to the directions of its Central Board, or of debentures or fully paid shares of companies without limited liability in India or elsewhere.

Competition with exchange banks allowed.

It is obvious from the above that it can also undertake exchange operations and thus compete with the foreign exchange banks too, but it has not done this so far. It can now establish its branches outside India also, though it has only one such branch *viz.*, London, at present. The restrictions with regard to the kinds of business it could do there have now been removed altogether.

Relation with provincial and central co-operative banks.

The provincial co-operative banks maintain small current accounts with the Imperial Bank, and also get cash credit and overdraft facilities from it. The central co-operative banks also do the same to some extent. Primary co-operative societies have, however, no relation with it.

Its relation with the indigenous bankers.

The indigenous bankers and money-lenders usually do not maintain accounts with the Imperial Bank. During busy season, when supply of hundis is greater than their resources, a temporary connection is, however, established between a number of them who are selected and placed on its approved list. Hundis drawn and endorsed by them are rediscounted with it up to certain maximum limits determined according to their financial standards. Sometimes advances against demand promissory notes signed by two of the indigenous bankers are also granted by it.

Q. 163. Are there any limitations imposed upon the nature of the business that the Imperial Bank of India can undertake ? What are these

*and how do you justify them ?** (*U. P. 1933*)

A. The limitations imposed by the Imperial Bank of India Act (1920) upon the businesses that the bank could undertake were as follows :—

(1) It could not make any loan or advance for a longer period than 6 months ; or upon the security of the shares of the bank, or upon mortgage or security of immovable property, except to Court of Wards with the previous sanction of the Provincial Government concerned or upon the security of the documents relating to immovable property.

Restrictions (i) on loans.

(2) It could not discount bills for, or advance money to, individuals, or partnership firms beyond such sums as might be prescribed, except upon a security of specified kinds.

(ii) on discounting.

(3) It could not discount or advance money on personal security, unless such discounts or advances carried with them several responsibilities of at least two persons or firms unconnected with each other in general partnership.

(iii) on advance etc. on personal securities.

(4) It could not discount or advance money on the basis of any negotiable security having a longer period to run than 6 months.

(iv) on holding of securities with a distant date.

(5) It could not deal in foreign exchanges except for bonafide requirements of its constituents for their personal requirements.

(v) on foreign exchange business.

(6) It could not open accounts at the London branch for persons who, within the previous three

(vi) on business in London branch.

*This question has, here, been answered in the light of the changes brought about by the Imperial Bank Amendment Act (1934.)

years were not the customers of the bank in India or one of the Presidency Banks.

Formerly, it was a bankers' bank and the Government's bank, but now it is not so.

Comparison of the past with the present position. These restrictions were quite justified in view of the position of the bank. It was the Government and bankers' bank, and hence could not be allowed to take up any business which was risky even in the least. The position has, however, changed since the establishment of the Reserve Bank of India. Imperial Bank is not now a bankers' or Government Bank.

An agent of R. B. even now.

But it is still the agent of the Reserve Bank of India in places where it has its branches and the latter has none. As an agent to Reserve Bank it keeps its balances, and hence some of these restrictions still continue.

Relaxation of restrictions.

There has, however, been allowed certain relaxation in them.

Foreign branches.

(1) It can now establish branches or agencies at any place inside or outside India and undertake any banking business ordinarily allowed to it. Restrictions upon business in London branch have also been removed.

Buying and selling of foreign bills.

(2) It can buy and sell foreign bills of exchange of usance but not exceeding 9 months, if they relate to the financing of seasonal agricultural operations, and 6 months in other cases.

About advances etc.

(3) It can make advances and open cash credits on the security of the shares of Reserve Bank, or of debentures issued under the authority of a Municipal Board or Committee, or with the sanction of the Governor-General-in-Council, or of debentures issued under the authority of the ruler of an Indian state, or subject to the directions of its Central Board, or of debentures or fully paid shares of companies, with limited

liability, registered in India, or elsewhere. Further it has also been allowed to make advances against goods hypothecated to it as against only goods or documents relating to them in its possession formerly.

Q. 164. What services have been rendered to the cause of banking in India by the Imperial Bank since it came into existence? Discuss concisely how far its usefulness is likely to be affected by the operations of the Reserve Bank of India.* *(U. P. 1936)*

Extension of banking facilities to many new towns.

A. **Services rendered to the cause of banking by it.** The Imperial Bank of India has opened more than 300 new offices since its establishment. In many of these places, there was no branch of any joint stock bank previous to the opening of one by the bank. This means that these places have received banking advantage because of the Imperial Bank.

It has inspired confidence in modern banking and mobilised the capital of the country.

It has inspired confidence in the public. There had been numerous failures of joint-stock banks, and people had no confidence left in them. Imperial Bank was a Government bank, and they knew that it could not fail. So money was deposited with it. The bank, by coming to the assistance of the joint stock banks at different times when runs were made on them prevented their failures. This had the further effect of inspiring confidence of the public in them also. Due to this, deposits with Imperial Bank and also with joint stock banks have appreciably increased. Opening of new branches by it has also led to the conversion of the hoards at those places into bank deposits. It can thus be safely

said that the Imperial Bank has done a service to the country by mobilising its capital.

Facilities re: advances and rates of interest.

The places where the bank has opened its branches have also received the benefit of its advances. Not only this, but the rate of interest in them has also been appreciably reduced. In addition to this, the rate of interest in places where there is no branch of the bank has also gone down due to the fear of the bank being induced to open its branch there. This has not been done by only indigenous bankers; joint stock banks too have done so. As the Imperial Bank had also the Government balances with it, the funds that it could employ in this way were sufficiently huge. It was also given the power of getting emergency currency issued to the extent of 12 crores. This had the effect of steadying the high rate of discount that prevailed during the busy season.

Supply of emergency currency.

Remittance facilities.

Because of a very large number of its branches, it could give more of remittance facilities also. Not only did this bank give the increased remittance facilities but joint stock banks too were enabled to do this. The commission charged for rendering this service was also sufficiently reduced.

It was also expected that the bank would be able to increase the use of bills, by giving rediscounting facilities. This was, however, not accomplished as joint stock banks did not like to disclose their bill portfolios to one, in competition with them. However, the bank finances the movement of a large portion of crops by means of advances against stocks, discounting of bills, and purchase and sale of demand

Financing movement of crops.

drafts and telegraphic transfers. The bank has also succeeded in reducing the difference between its own hundi rate and bazar hundi rate. It has also reduced their fluctuations and removed the variations in the rates of the Bombay, Calcutta and Madras markets.

Effect upon various rates.

It has also built up close relations with the provincial co-operative banks and allows them over-drafts etc.

Accommodation to co-operative banks.

The bank established clearing centres at its important branches and thus provided to other banks this facility for the first time in the country. The number of cheques cleared increased every year.

Provision of clearing facility.

Effects of the establishment of the Reserve Bank upon its usefulness. The usefulness of the Imperial Bank has not at all been affected by the establishment of the Reserve Bank. It continues to inspire the same confidence in the public as in the past. Again, as it has been freed from certain restrictions on its business, its usefulness to the public has increased. Now it can grant loans for a longer period and against securities of various kinds. It can also take up exchange business now.

A great increase in its usefulness has been brought about.

**Q. 165. In what manner and to what extent does the Discount Rate of the Imperial Bank of India regulate the supply of credit in the Indian money market ?*

How far would the proposed Reserve Bank of India improve the money market situation ?

(U. P. 1934)

* The question is out of date and has been answered in an amended form.

I. B. rate was not the same as R. B. rate or the bank rate in any other country.

A. **Difference between Imperial Bank hundi rate and official rate**. Discount rate of the Imperial Bank of India was not the same as its bank rate, though in foreign countries there is no difference between the two. Bank rate, there, as well as the bank rate in India, since the establishment of the Reserve Bank is the rate at which the central bank of the country is prepared to rediscount first class bills. The bank rate of the Imperial Bank was, on the other hand, the rate at which it was prepared to grant loans on the basis of the Government securities. The discount rate of the Imperial Bank of India was, however, the rate at which it was prepared to rediscount first class hundis. This rate was sometimes higher and at others lower than the official bank rate. Unlike the bank rate it also fluctuated according to the daily conditions. Bank rate, on the other hand, is fixed every week on a particular day as a result of the decisions at the meeting of the directors specially convened for the purpose, and never changes within the week in normal circumstances. Imperial Bank rate was also fixed in the same way and did not fluctuate within the week.

I. B. hundi rate differed from the official bank rate quoted by it.

Its effectiveness or otherwise. Imperial Bank discount rate was not effective. It did not control the money market. Nor was there any connection between this rate and other rates. The same was true of the Imperial Bank rate. In other countries bank rate plays a very important part in the controlling of the money market and supply of credit in the same. Deposit rate is 2% lower than the bank rate. It should also be remembered that interest is only

Connection in other countries.

allowed there on fixed deposits and not on current deposits as is the case in India with some of the banks. In addition to cash, the liquid resources of the banks in foreign countries consist of chiefly bills discounted, and money at call or short notice. In this country, there is no advance made on what is called money at call or short notice, as there are no stock exchanges in all the places. Even in Calcutta and Bombay very little money is advanced on this account. A bill market does not exist in this country at all, and hence very few bills are discounted with joint stock banks here. These too were not rediscounted with the Imperial Bank by them as they did not want to disclose their bill portfolios to a bank which competed with them for it. Joint stock banks, here, charged for this reason whatever rate of discount they liked or could get according to the conditions in the market. Some of the indigenous bankers discounted their hundis with the Imperial Bank of India, only during busy seasons. It must not be forgotten that the bank discounted the hundis of only those indigenous bankers which were on its approved list and only to the extent of the amount noted down against them, already determined according to their supposed financial standings. Besides, the discount rate charged from each indigenous banker varied and was not the same in all the cases as the bank discount rate.

Interest on current accounts allowed only in India.

Absence of demand for money at call or short notice.

Absence of a bill market.

Variation of I. B. dis- rate.

Various deposit rates of joint stock banks had no connection with the Imperial Bank hundi rate. Nor was there any connection between the bazar hundi rate and the Imperial bank hundi rate. In fact, indigenous bankers, as has already been seen, seldom discounted their hundis with

Peculiarity of the conditions.

the bank. The bazar rate was also not one and the same between different bazars in different parts of the country or in the same town. Calcutta bazar rate was quite different from the Bombay bazar rate and in Bombay itself all the different bazar rates, namely, Multani bazar rate, Marwari bazar rate, Bhatiya bazar rate, etc., were quite different from one another.

Periodical difference.

Then, there was a great difference between these bazar rates at different periods. Rates during busy seasons were higher than the rates during slack seasons.

Effectiveness of the Reserve Bank of India Rate. The Reserve Bank of India rate is, however, more effective. First of all, it is the bank rate, as has already been seen, in the same sense as are the bank rates of other countries. Then, all the scheduled banks are required to maintain a fixed percentage of their demand and time liabilities with the Reserve Bank, failing which they are fined at a graduated rate which is higher than the bank rate. This restricts them from granting loans to their customers at lower than the bank rate, and allowing interest on deposits at a rate higher than it. Then, they have no objection in rediscounting their customer's hundis with the Reserve Bank for there is no fear of any loss due to disclosing their bill portfolios to it as it does not compete with them. But the Reserve Bank rate has failed to regulate Indian bazar rate, as the indigenous bankers who control the same, have still not been brought under its control Several schemes have been circulated and adoption of any one of them would result in bringing them also

R. B. rate is the bank rate in the true sense.

Connection between this rate and other rates.

Scheduled banks rediscount their bills with it.

Its failure to control Indian bazar rate and indigenous bankers.

under control. Then, the Reserve Bank of India has also got the power of issuing notes to a very considerable extent against bills and an extended use of the same shall be able to steady the discount rate at all periods. The difference between the rates at different places also tends to decline due to the better facilities for remittance afforded by it.

Periodical and local rates becoming steady.

Q. 166. Why is it that Imperial Bank of India was not developed into a central bank? Give your own opinion on the propriety of the action. (*Rajputana*)

A. **Reasons for not developing Imperial Bank into a Central Bank.** Imperial Bank of India has always been charged with showing favouritism to non-Indians. This is perhaps so because a majority of its shares is in their hands. Most of the members of the central and local boards are also Europeans. Then, the superior staff of the bank also consists largely of the same. It has been often said that as a result of all these factors the bank has been resorting to racial and political discrimination to some extent in granting financial accommodation. Contrary to this, a majority of the shares of the Reserve Bank of India is in the hands of the Indians. But this alone is not enough, as there is no restriction on their being passed from their hands to those of a certain class of non-Indians. Then, a majority of its directors are at present Indians. This is also good but it has been so often suggested that both the Governor and Deputy Governor should also be compulsorily Indians. In fact, the central bank of a country should purely be a national concern so that its policy may be directed solely in the interest of the country.

I. B. owned and managed by mostly non-Indians

Position of R. B.

Its status as a central bank with com. banking functions injurious to other banks.

Besides, Imperial Bank of India could not be developed into a central bank because it did undertake important commercial business. If it had been given the functions and status of a central bank without depriving it of its commercial banking functions, it would have become far more powerful, and would have been able to offer more serious competition to other banks in the country, and might even have threatened their existence. In fact, the holder of the ultimate reserves of the country should not itself be the channel through which credit is given to individuals and firms. Moreover, the bank could not have functioned adequately as a banker's bank, because it might have been tempted to withhold sufficient help from its rivals even if they needed and deserved it; and they, far from regarding it as their saviour in their time of need, would have been always suspicious of its attitude towards them, and jealous of its special privileges. Further, the bank would have been suspected generally of managing the currency more in its own interest than those of the country. Furthermore, the bank could not have been able to perform both the commercial and central banking functions efficiently, as it would have been heavily burdened.

They would have suspected it.

Possibility of its managing the currency in its own interest.

Heavy burden.

Conclusion.

From the above discussion, it is clear that it could be developed into a central bank only by depriving it of its commercial banking functions, though the same would not have been in the interests of the country due to its having been in the hands of non-Indians.

Deprivation of banking facilities from many places.

The deprivation of commercial banking function would, however, in itself have been against the interests of the country. Firstly, there are

many places where Imperial Bank is the only bank doing commercial business. These would have been deprived of their banking facilities. In many places where there are also the branches of other banks, its cessation of taking up commercial banking functions would have given them its monopoly. This would have resulted in a loss to the people in general. Besides, Imperial Bank has inspired confidence in the public and many persons have deposited their money with it. They would have been compelled to withdraw at least what they had deposited in fixed deposit accounts with it as it could not have been allowed to continue receiving deposits in fixed deposit accounts, because this would have meant allowing it to compete with other banks. The Reserve Bank of India has not been allowed to receive deposits on interest with this very view. Acceptance of deposits on interest presupposes profitable investment and hence the risk which a central bank cannot undertake keeping in view its position. Perhaps many of the persons compelled to withdraw their money from the Imperial Bank would not have liked to invest it anywhere else and might have converted the same again into hoards. The Imperial Bank of India has raised the standard of commercial banking by its own working; if left to themselves, other banks might have lowered it down. This would have been quite detrimental to the interests of the country.

Monopoly of J. S. banks.

Money deposited as fixed deposit would have been compelled to be withdrawn perhaps never to return again for investment.

Possibility of lowering down of banking standard.

Q. 167. Show to what extent the Imperial Bank of India was performing the functions of a Central Bank before the establishment of the Reserve Bank of India. Discuss whether it could be possible for the Imperial Bank of India to have developed into a Central Bank. (*Allahabad, 1942*)

A. **Functions of a central bank performed by the Imperial Bank of India before the establishment of the Reserve Bank of India.** The following were the functions of a central bank which the Imperial Bank of India performed before the establishment of the Reserve Bank of India :—

Govern-ment banker.

First of all, it acted as a Government banker, and as such managed its treasury work free of cost. As soon as it was established, Reserve Treasuries were abolished, and all balances transferred to its headquarters and branches. It received all moneys and made payments on behalf of the Government. It also managed its public debts. The London Office managed the rupee debt.

Bankers' bank.

Next, it acted as a bankers' bank. Most of the leading joint stock banks kept their surplus balanees with it although it was not a legal obligation upon them to do so. It rediscounted the bills and hundis as well of the approved indigenous bankers and joint stock banks, but the latter seldom approached it for accommodation as they did nor want to disclose the nature of their business by submitting their bills and hundis to one who was a formidable rival to them.

Manage-ment of clearing house org.

It managed clearing house organisation also. In fact, it was first to introduce this arrangement in this country.

Provision of emergency currency.

Under Act of 1923, the Imperial Bank was also required to provide emergency currency to the business community. The Government placed at its disposal Rs. 12 crores from the Paper Currency Department when the bank rate was six per cent or above. The Imperial Bank was to invest this money in discounting first class

genuine trade bills of 91 days' duration, and transfer them to the Paper Currency Department as security against the extra issue.

Remittance facilities.

It also provided remittance facilities to exchange banks, joint stock banks, co-operative banks and the public. Its rates to the banks were lower than to the public. Indigenous bankers, it may be noted, were treated as public for this purpose.

Bank rate.

Bank rate was also announced by the Imperial Bank just as it is announced by central banks in various other countries. This was, however, different from its discount rate.

Misecllaneous services.

The bank also helped the money market in other ways. It under-took to repay 50 per cent of deposits including current accounts and savings bank deposits of the Alliance Bank of Simla immediately on the suspension of its payments and thus prevented the ruin of many.

For an answer to the second part of the question, please consult answer to Q. 166.

APPENDIX

SUPPLEMENTARY QUESTION

A. 1. Discuss the extent to which the Imperial Bank of India was performing the functions of a Central Bank before the establishment of the Reserve Bank of India. Why did the majority of the Hilton Young Commission reject the idea of turning the Imperial Bank into a Central Bank ?

(Allahabad, 1940)

Please look to the answers to Qs. 166 and 167 on this topic.

CHAPTER XXII

RESERVE BANK OF INDIA

Q. 168. Discuss the desirability of the establishment of a central reserve bank in India.*
(U. P. 1933)

Presidency bank.

A. History. The demand for the establishment of a central reserve bank in the country was very old. It was to meet this demand that three Presidency banks had been started in a very early period of the British Raj. During and after the last European War of 1914-18, the need for a central bank for the whole of the country was keenly felt and as a result the three Presidency banks were amalgamated into one, and the Imperial Bank of India came into existence in 1921. But the Imperial Bank of India too was not given all the central banking functions to perform. Neither could the functions already given to it be extended. The need for the establishment of a central reserve bank was emphasised by the Hilton Young Commission, and various Provincial and Central Banking Enquiry Committees.

Imperial bank.

Its shortcomings.

Maintenance of internal and external stability of the value of the rupee.

Reasons for establishing the Reserve Bank. First of all, it was thought necessary to establish the Reserve Bank in order to maintain the purchasing power of the rupee stable both internally and externally. Internal stability depends upon internal as well as external factors and it was thought that the external factors could be

*Now that the Reserve Bank of India has been established, the question has been answered in a different form.

dealt with only by the international co-operation of the central banks of different countries. Internal factors, however, could be dealt with by a central bank more easily, and it was thought that a central reserve bank would be able to deal with them by adjusting the supply of monetary circulation to demand for it. The external stability of a currency unit depends on the other hand, to a very great extent upon its internal stability. It was thought that a central reserve bank could maintain this stability to a considerable extent by its monopoly of note issue, and power to impose a judicious and appropriate credit policy. The external stability also required the bank to be given the right of the purchase and sale of sterling to an unlimited extent.

Powers given to it with this end in view.

It was also thought that the failure of the banks in this country could be minimised by the establishment of a central reserve bank and giving it the power of holding all the reserves of the country in one single place. It was only with this view that the Reserve Bank of India has been given the power of holding all the reserves. Not only that it holds all Government balances and paper currency reserve, it also holds reserves of all the modern banks to some extent. Every scheduled bank has been forced to keep a balance to the extent of at least 5% and 2% of its demand and time liabilities respectively with it. Besides, the Reserve Bank, because of its power to issue notes according to requirements, is in a position to help the banks in times of crises by issuing further currency. There is another advantage of single reserve system, namely, mobility of money. It can be transferred quickly from a centre where

To minimise the failure of banks by centralising all the reserves at one place.

Power of note-issue also helps this.

it is abundant to another where it is scarce.

To remove instability and uncertainty in the Indian money market by making its bank rate effective.

There was a great instability and uncertainty in the Indian money market and this could not be prevented without bringing into control of a central reserve bank the different discount and interest rates prevailing in it. In all the other countries of the world official bank rate is the regulator of all the different rates, and it was thought that the same could be done in this country. This has, however, been not made possible so far in this country because of certain short-comings in the Bank Act. They will, however, be removed in due time.

Certain short comings in the Act.

Compilation and publication of various statistics relating to banks.

There was no arrangement for the compilation of proper and extensive statistics regarding the working of banks and indigenous bankers, and operations in the money market, and their prompt publication. This is only possible if a central reserve bank is established. The Reserve Bank compiles and publishes the various statistics relating to the scheduled and non-scheduled banks, etc. It can also extend its usefulness by compiling and publishing statistics relating to indigenous bankers.

Necessary for performing all Government financial business.

A central reserve bank is necessary to perform all the financial operations of the various Governments in this country at home and abroad. The Imperial Bank, however, performed this function.

Financing of agriculture.

The methods of financing of agriculture were far from satisfactory. A separate department, namely, the agricultural credit department has been opened in the bank for this purpose, and it is hoped that it will bring about a

gradual improvement in the financing of agriculture.

There was also felt the necessity of making a particular bank responsible for the development of banking in this country and taking steps to promote its advancement on the right lines in the interest of the nation as a whole. This could only be expected of a central reserve bank.

Making a particular bank responsible for the development of banking in the country.

*Q. 169. What are the functions of a central bank? Discuss how far the Reserve Bank of India is expected to perform the functions of a Central Bank.** *(1936)*

A. For the functions of a central bank please refer to the answer to Q. 126.

The Reserve Bank of India performs all these functions of a central bank. Firstly, it has the monopoly of note-issue. No other bank or the Government† has this right. The bank took over the liability of all the notes of the Government of India already in circulation on the date of its commencement of this business. Paper currency reserve and gold standard reserve were both unified on that date and their different constituents were handed over to the bank in such proportions as to enable it to maintain the paper currency reserve according as it is required of it under the Act. The bank, however, issued its first notes in the year 1938. The denominations of the notes it can issue have

Monopoly of note-issue.

Reserve.

Other informa-

* Now that the Reserve Bank of India has been established the question has been answered in the light of the working of the Reserve Bank of India.

† Since July, 1940, the Government of India issue notes of rupee one also as a war measure.

tions regarding it.

been sanctioned by the Governor-General-in-Council. The notes of the Reserve Bank of India are unlimited legal tender in the country. They are convertible either in rupee coins or one-rupee notes, which are issued only by the Government of India. It has a separate department for the performance of this function, namely the Issue Department. The bank publishes its balance-sheet of this department along with the balance sheet of its banking department every week.

The sole channel for the out and intake of all forms of legal tender currency.

The bank does not only issue notes, it is in fact, the sole channel for the out and intake of all forms of legal tender currency. Besides its notes, there are one-rupee notes, rupee coins and other subsidiary coins in circulation in this country. They are all issued by the Government only through it If the bank has a surplus of them, the Government takes it back.

Holder of all government balances.

The Reserve Bank holds the balances of all the governments in the country. The amount held by it on this account may be found out from its weekly balance sheet of the banking department.

Banker's bank.

The Reserve Bank of India is also the bankers' bank. Every scheduled bank is compelled to maintain with it a balance of at least 5% and 2% of its demand and time liabilities respectively. In countries where the central bank came into existence before the establishment of the other banks, it naturally became their banker, and the necessity of providing a statute for compulsory maintenance of some balances by other banks with the central bank has not been felt. The case of Bank of England provides an illustration.

But in countries where the central banks came into existence after other banks had already been into existence, the provision of a statute for compulsory maintenance of a minimum balance by other banks with the central bank has been felt necessary.

Government's agent for performing its business at home and abroad.

The bank also acts as an agent to the various governments for performing their financial operations at home and abroad. It manages all public debts and advises the various governments as to the suitability of the time with regard to their floatation. It also purchases sterling on behalf of the Government of India for payment of home charges.

Compulsory purchase and sale of sterling to maintain external value of rupee.

The Bank is responsible for the maintenance of the sterling value of the rupee. For this purpose, it is obliged to purchase and sell sterling for delivery in London at fixed rates in sums of not less than £10,000 at a time. In fact, a very great stress has been laid down in this country upon the maintenance of the sterling value of the rupee. Contraction of currency has been several times resorted to, with this purpose in view, though this has resulted in a shortage of capital for industries. It is rather more necessary to maintain the internal stability of a currency than the external stability. But, in the case of rupee, this has been sacrificed, the aim being just the opposite.

Greater stres laid in this country on maintenance of external value than internal value.

Steady rate of interest throughout the year and all over the country.

The Reserve Bank was also expected to steady the rate of interest in different seasons of the year and between rural and urban areas. But this has not been done, perhaps due to the fact, that a very important constituent of the Indian money market, namely the indigenous banker is out of its control. Something must be done to co-ordinate his activities also.

Compilation and publication of banking statistics.

The bank also compiles important banking statistics and makes arrangement for their publication. Its own balance sheet, along with the various informations regarding the scheduled banks, provides an index of the monetary conditions in the country. Recently the bank has also been given the facility of obtaining statistics regarding non-scheduled banks from the Registrar of the Joint Stock Banks.

Q. 170. What functions are performed by Central Banks? How far is the Reserve Bank of India performing those functions?

(U. P. 1942)

A. For an answer to this question, please refer to the answer to the last question.

Q. 171. What provision has been made in the Reserve Bank Act for financing agriculture? Do you consider that adequate provision has been made for rural credit? If not, give your suggestions. (U. P. 1938)

Purchase or rediscount of ag. bills of longer tenures allowed under certain conditions.

A. **Provisions contained in the Reserve Bank Act for financing agriculture and suggestions for improvement.** Reserve Bank of India Act provides for financing agriculture by allowing the bank to purchase or rediscount agricultural bills endorsed by a scheduled bank or a provincial co-operative bank. These bills may be drawn either for financing agricultural operations or for marketing of crops. Though in the case of other kinds of bills, the date of maturity cannot fall after a longer period than three months from the date of the purchase or rediscounting of the same by the bank, it may fall after 9 months in the case of agricultural bills.

The bank is also permitted to make loans payable on demand or within 90 days to provincial co-operative banks on the security of promissory notes supported by documents of title to goods. All this, however, is not satisfactory. Firstly agricultural bills for the purposes mentioned herein do not arise at all in this country, and hence there is no chance for financing agriculture in this way. Next, the loans to provincial co-operative banks should have been allowed to be made available also on the security of the Government papers and debentures issued by them and guaranteed by the Government. Even the facility afforded under the Act cannot be availed of by all the provinces where there is an absence of a provincial co-operative bank. Our own province, U. P., provides an instance.

Loans to provincial co-operative banks also allowed under certain conditions.

Agricultural bills do not arise.

Necessity of allowing loans to provincial co-operative banks on certain other kinds of securities

Then, the bank had to establish an Agricultural Credit Department. Its function is to maintain an expert staff to study all questions of agricultural credit and advise the various interested bodies in these matters. It is also meant to co-ordinate the operations of the bank in connection with agricultural credit and its relation with provincial co-operative banks and any other banks or organisations engaged in the business of agricultural credit. Only this much is not sufficient. The Agricultural Credit Department should have funds of its own to grant advances against agricultural produce for one year.

Establishment of an agricultural creidit department.

Need for an extension of its functions.

The Act had also laid upon the bank the responsibility of suggesting legislation for the improvement of machinery for dealing with agricultural finance and methods with a view to effect a closer connection between agricultural enterprise and

Responsibility of suggesting legislation for providing better credit to

farmers and for linking the indigenous bankers to it.

its own operations. It was also to report on the question of the extension of the provisions relating to scheduled banks to persons and firms engaged in British India in the business of banking, particularly those who are called indigenous bankers. In pursuance of these, the bank submitted a preliminary report to the Government of India at the end of 1936. It pointed out that the bank could not help the agriculturist so long as he was not made credit-worthy by a reduction of his previous indebtedness, special institutions providing long-term credit were not organised, money-lenders were not regulated, improvement was not effected in the marketing organisation, agriculturist's earning capacity and purchasing power were not increased and an improvement was not brought about in his standard of living. In 1937, again, the bank sent a letter to all scheduled banks and shroff's associations stating that under the prevailing conditions, it could deal with the indigenous bankers only through some intermediate agency, but that it was prepared to consider any practical scheme for organizing indigenous bankers to enable credit to be afforded to them direct. Pending the establishment of such organisations the bank suggested in the letter a provisional scheme by which it could deal with the indigenous bankers through scheduled banks. In September of the same year a scheme for linking of indigenous bankers with the bank was further circulated. However, nothing substantial has been done in this respect so far. The problem ought to be solved without delay. So long as indigenous bankers are not linked with the bank, rates of interest in rural areas will remain high. Legislation for reduction of the previous

Various reports in this connection.

Nothing done so far.

debt of the agriculturists, regulation of money lenders and marketing organisations should also be immediately taken up. Institutions like land mortgage banks for making long-term advances on the security of land mortgages should at once be established in all the provinces. The earning capacity of the argiculturists must be increased. **Steps necessary to be taken.**

Q. 172. Describe briefly the functions of a Reserve Bank of India under two heads: (1) Currency functions, (2) Banking functions.

(*U. P. 1940*)

A. **Currency functions of the Reserve Bank of India.** Currency functions of the Reserve Bank of India are as follows :—

(1) The bank has the sole right to issue notes. For this purpose it has a separate department, namely, the Issue Department. All the notes issued by the bank constitute its liability, while all the reserve maintained against them form its assets. The denominations of the notes the bank issues or can issue, have been sanctioned by the Governor-General-in-Council. The various items of the reserve, and their amounts have been laid down in the Act. **Note issue business.**

(2) These notes are convertible into rupee coins, subsidiary coins and one rupee notes. They are all issued by the Government of India, but only through the bank. If there is any surplus of them with the bank, it may be returned to the Government. Worn out coins and old one rupee notes are taken back by the Government through it. **The sole channel for the in and outtake of all forms legal tender currency.**

(3) The paper currency reserve of the bank has been so constituted as to allow the easy **Elasticity of note-issue**

due to the percentage system.

expansion and contraction of currency. The percentage system of note-issue has secured sufficient elasticity.

Maintenance of the sterling value of the rupee

(4) The bank also maintains the sterling value of the rupee. For this purpose, it purchases and sells sterling for delivery in London at fixed rates in sums of not less than £ 10,000.

Competition between the Reserve Bank and other banks not allowed.

Banking functions. The banking functions of the bank are many, but they have been so designed as not to allow competition between this bank and other banking institutions of the country.

Receipt of deposit.

Firstly, it receives money on deposit but without interest from, and the collection thereof for, the Secretary of State, the Governor-General, Local Governments, Indian states, local authorities, banks, and any other persons.

Purchase etc. of bills.

Secondly, it purchases and rediscounts bills of exchange, etc., drawn and payable in India, and arising out of commercial or trade transaction bearing two or more good signatures, and maturing not more than ninety days after the date of such purchase or sale. It also purchases and rediscounts such bills etc., arising out of the financing of agricultural operations or the marketing of crops. But in this case the pariod of maturity may fall after 9 months. None of these bills, etc. can, however, be purchased or rediscounted unless it bears the signature of at least one scheduled bank. The signature in the case of agricultural bills may also be that of a provincial co-operative bank.

Purchase and sale of sterling and

It also purchases from and selis to scheduled banks sterling in amounts of not less than

£ 10,000. Bills (including Treasury Bills) drawn in U. K. or upon U. K. may also be purchased, rediscounted and sold provided their date of maturity does not fall after 90 days from the date of purchase or rediscounting. These transactions can, however, take place in India only with a scheduled bank. *other foreign exchanges.*

The bank makes loans for a period not exceeding ninety days to states in India, local authorities, scheduled banks and provincial co-operative banks against prescribed securities, and grants advanced to the Governor-General and to local governments for a period of not more than 3 months. *Loans.*

It issues bank drafts payable at its own offices or agencies to facilitate transfer of money. It also carries on agency business on behalf of the various governments in this country. *Remittance of money.*

It also purchases and sells government securities of U. K. and India and its provinces of prescribed maturities and to the prescribed limit. *Purchase and sale of government securities.*

The bank can also borrow from a scheduled bank in India and any central bank in any country with certain limitations. *Borrowing.*

Q. 173. Describe briefly the existing rural credit agencies in India. Has the Reserve Bank anything to do with rural credit? (1940)

A. **Description of the existing rural credit agencies.** It is impossible to give herein a description of the existing rural credit agencies in this country, however brief we may try to be. To use Sir Alfred Lyall's famous phrase we may say that they form 'a tangled jungle *A tangled jungle of disorderly transaction.*

of disorderly transaction.' Notwithstanding this, we will make an attempt to describe them in broad groups.

Kinds.

First of all, there are professional money-lenders. These are both fixed and itinerants.

Fixed.

The fixed live in villages. They are the village bania, and the village mahajan. The village

Description of a village bania's business.

bania is a petty tradesman. He belongs to one of the lower castes, *e. g.*, the teli, the kalwar, the halwai. His capital is small, rarely exceeding a thousand rupees. In fact, the fortunes of these money-lenders and those of their clients are identical. In a good season, their dues are promptly paid, and clients and creditors grow prosperous together. In a bad season, their dues remain unpaid and creditors and clients alike suffer. This community of interest produces a fellow-feeling between them. The village bania never cares for security of any kind. The

A village mahajan.

village mahajan is, however, more important. His business is on a much larger scale. He possesses greater resources and deals in bigger

Points of distinction between the two.

amounts, and with a more numerous clientele etc. The mahajan's transactions are loans in the correct sense of the word. They are not credit sales like those of a village bania. He, however, lends both money and grain, and demands them at the time of repayment. Then, the transactions of a village mahajan are more governed by business principles. He, has no personal considerations and if he shows leniency to his clients, it is also as a business principle. Many of them are usurers They come out of better classes of society, *e. g.*, Rastogi, Brahman, Bohra and Rajput. Besides these two types of fixed money-lenders, there is

Sahukars.

also the Sahukar. He, however, lives in a town

and usually finances the rural people through mahajans. He gives direct loans only to rich people and in big amounts.

Itinerant money-lenders.

Qistwalas.

Then come the itinerant money-lenders. They are the qistwalas, the kabulis, the harhias, the beoparies, etc. The qistwalas are perhaps the most important of this class of money-lenders. The oldest and still the most common form of qist loans is one of Rs. 10 repayable in 12 monthly instalments of one rupee each. This fact in itself supplies a sufficient explanation of the system. **Kabulis.** The kabulis are from Afghanistan and the Frontier. They lend money or tempt the victims into buying their wares, generally cloth. They are the usurers of the worst type, and are all the more dangerous by reasons of their readiness to resort to force. On the slightest provocation, they assault their borrowers. **Harhiyas.** The harhias are found only in certain places. They lend money in small sums and also deal in cattle. In case of default in repayment, their habit is to sit dharna at the door of the debtors. **Beoparis.** The beoparis are also a wandering cattle-dealers. They sell their animals on credit. The price is payable in four half-yearly instalments. They also make petty loans at exceptional extortionate rates of interest. There are several others but of only local importance.

Amateurs.

Different people.

We have also the amateurs. They are the pensioners, both civil and military, temple-priests, petty officials, *e. g.*, patwaris and school masters estate servants village servants, etc The rich land-lord lends to the poor land-lord, to his own and other people's tenants; the rich tenant lends to his own and those of other land-lords, as well

as to his fellow tenants. The methods of the agriculturists and money-lenders are in many cases the same as those of mahajans, but they have an ulterior motive—sometimes that of becoming the masters of the land of their client. The zamindar money-lender is very objectionable. He acquires a double hold over his tenant. If a tenant pays his rent, but not the interests on his debt, the landlord can sue him in a civil court. If the tenant pays the interest on his debt, but not his rent, the landlord can sue in a revenue court. Worse still, the landlord can, if he chooses, credit all payments made by the tenant to his debt and so keep him in arrears with his rent, which puts the latter's crops in his power by distraint, and gives him the right to eject. The tenant money-lender is from amongst the tenants themselves. Their rise indicates prosperity. Again, if the land passes from one tenant to another, there is not much harm. It may lead to improved farming by making large scale production possible.

Agriculturist money-lender.

Zamindar money-lender.

Tenant money-lender.

A new kind of rural credit agency has sprung up in this century. It consists of co-operative credit societies. These are the voluntary associations of the borrowers themselves. They practise thrift and deposit regularly a small sum with their society. They also raise money easily from outside agencies on the basis of the credit of all the members jointly. There are central and provincial co-operative banks which finance them. These societies grant loans to their members, and for any loans granted to a member, all other members stand jointly responsible. They are managed by the members themselves. As they teach thrift, co-operation and business

Co-operative credit organisations.

principles to the farmers, they provide the best type of rural credit agency. Their formation should be encouraged.

The Reserve Bank and rural credit. The Reserve Bank is allowed to rediscount agricultural papers of certain types. But these arise very rarely. It lends to provincial co-operative banks on certain conditions. It also lends to indigenous bankers through scheduled banks. These indigenous bankers lend to the farmers through money-lenders. In fact, something ought to be done to enable the indigenous bankers to come in direct contact with the bank. A scheme was circulated by the bank in 1937 with this object in view but so far nothing appreciable has been done in this respect*. **What it does and what it ought to do.**

Q. 174. How are cheques cleared in India? Explain the principle on which the clearing business is done. *(U. P. 1938)*

A. **Clearing business in India.** Cheques are cleared in India at different places. In five of these, it is done through the Reserve Bank of India, and in the rest through its agent, namely, the Imperial Bank of India. A bank can become a member of a clearing house by the consent of the existing members. New members are admitted after a close scrutiny of their balance sheets by a committee of these members. Complaints have been made that admission for Indian banks is severely difficult because the majority of the members consisting of foreign banks oppose it. These clearing houses clear **Admission.**

*For a detailed answer to this part of the question, please refer to the answer to Q. 170.

They clear only local cheques.

Extension desirable and possible.

Procedure followed.

locally payable cheques only, and cheques payable in any *other town have to be sent there for collection.* This involves much inconvenience, delay and also expense. As the Reserve Bank holds the balances of all the principal banks in the country, it can carry out the prompt collection and clearing of such cheques itself or through its agent bank by means of a simple book entry and the mere transmission of a message or credit. The procedure followed in clearing is as follows. A representative of each member bank attends at the clearing office on each business day at the time fixed to deliver all cheques negotiated by it on other member banks and to receive all cheques drawn on itself and negotiated by them. After all the cheques have been received and delivered, the representative of each bank advises the clearing bank of the difference between his total receipts and deliveries and the clearing bank thereafter strikes a final balance to satisfy itself that the totals of the debtor balances agree with the totals of the creditor balances. The debtor banks thereafter arrange to pay the amounts due on them to the clearing bank and the clearing bank pays to the creditor banks the respective amounts due to them. In actual practice, however, no payment or receipt in cash takes place as all the member banks have an account with the clearing bank. It debits the accounts of the debtors banks with the amounts due on them and credits the accounts of the creditor banks with the respective amounts due to them, the corresponding entry being made in the clearing a/c.

Offsetting of the

The principle on which clearing business is done. The clearing business is done on the

principle of offsetting the cross obligations of the members and paying the differences. In fact, the differences are also not required to be paid, as each bank maintains an account with the clearing bank and these accounts, as has already been seen, are debited or credited according as is required. Formerly, each bank presented to the other, cheques drawn upon it. Now, the cheques negotiated by a bank and drawn upon another are offset by cheques drawn upon it and negotiated by that particular bank. This having been done, differences are offset and any balance left thereafter is cleared through the clearing bank. In fact, this involves a balancing of reciprocal liabilities with ultimate transference of balances from accounts.

cross-obligations.

Q. 175. What do you understand by Elasticity of Currency? What provision has been made in the Reserve Bank of India Act with a view to introduce the element of elasticity in the Indian Currency System? How can emergency credit be issued by the Reserve Bank?

(U. P. 1937)

Elasticity of currency. By elasticity of currency, we mean its capacity to expand and contract according to the demand. In its absence, prices fluctuate within a very wide range. This is not good for business prosperity. The Quantity Theory of Money lays down that the prices vary in exact proportion as the supply of money varies in relation to the demand for it. This means that the prices are halved, if supply of money is halved, say, because demand for it has been doubled or *vice-versa.* If there is elasticity, the supply of money also becomes

Expansion contraction according to requirements.

doubled with the doubling of the demand for it and *vice-versa*. This is necessary for steadiness of prices.

Sufficient elasticity has been secured.

Provision in the Reserve Bank Act. It has been so provided in the Reserve Bank of India Act that sufficient element of elasticity has been introduced in the Indian currency system. The Reserve Bank of India has been given the power to issue notes. In case, the country has a larger favourable balance of trade, sterling is purchased from the exchange banks and sterling securities are held in the paper currency reserve for the notes issued. If the bank thinks it necessary to expand currency, it can do so by purchasing Government securities in the open markets and holding them in the paper currency reserve for the notes issued in order to pay up their prices. Then, the bank can also hold bills against notes issued. During busy seasons, when trade is brisk, bills are drawn and discounted with scheduled banks which can get them rediscounted with the Reserve Bank. It can issue notes by placing them in its issue department. In fact, holding of bills provides for expansion of currency and their maturity for contraction. This is automatic.

The methods followed in expanding and contracting currency.

Against government securities and bills.

Issue of Emergency Currency. The Reserve Bank can issue emergency currency against government securities and bills of exchange. The assets of the joint stock banks in India consist mainly of these. If they feel the necessity of allowing larger credit, they may get these assets transferred to the Reserve Bank which can issue fresh currency against them. But supposing that by the issue of this currency,

their holdings of the bills and securities become so large that the total amount of the holdings of gold bullion, coins and securities falls short of the required minimum percentage of the total asset, there is also a provision for the same in the Bank Act. This minimum percentage can be reduced to any extent by paying a graduated tax by the bank to the Government.

Provision for lowering down even the minimum percentage of reserve in gold, and sterling securities.

*Q. 176. Discuss what methods will be employed by the proposed Reserve Bank for India for controlling the currency and credit of this country.** *(U. P. 1935)*

A. **Control of Currency.** The Reserve Bank of India, as constituted, has been handed over the currency function. It has not only the sole right of note issue but is also the sole channel for the in and out-take of metallic currency. This enables it to control the volume of currency according to the requirements. The bank is always in close touch with the money market. All the scheduled banks keep with it a fixed percentage of their demand and time liabilities, and send their weekly returns to it. Though the non-scheduled banks do not keep any balance with it, yet in pursuance of the Indian Companies Amendment Act (1938) the Registrars of Joint stock companies send one of the copies of the Returns of these non-scheduled banks also to it. The bank is, thus, in the know of all about the conditions in the money market. It is in the light of these informations and of requirements according to the conditions that the bank arranges to expand and contract currency in the

Monopoly of note issue and sole channel for the in and out take of all other forms of currency.

It is always in close touch with the conditions in the money market.

*Now that the Reserve Bank has been working for sometime, the question has been answered in that light.

Circulation of notes based on business transactions.

country. Circulation of its notes is directly based on business transactions, as they are issued in connection with the rediscounting of bills. It is enabled because of the unification of the gold standard reserve and paper currency reserve to keep during the slack season a higher percentage of gold and sterling reserves than that required by the statute, so that during the busy season it is enabled to issue more notes for financing the crops without increasing the reserve. The supply of additional currency by the bank against proper cover is automatic, and there is no need to raise the rate of discount on this account.

It can issue larger currency during busy season because of high percentage of gold and sterling reserves it normally keeps.

Bank rate policy.

Control of Credit. It also controls credit by its bank rate policy. It is also allowed to carry on what are known as open market operations. When banks grant credit, their liabilities rise up. Now, they have to maintain with the Reserve Bank a percentage of their liabilities. Hence, with every increase in the amount of their liabilities, they have to maintain an increased balance with the bank. This, they can secure from it by rediscounting their bills or handing over their investment securities to it. The bank rediscounts at its own rate and hence in case it thinks it necessary to limit the power of the banks to grant credit it can raise its bank rate. When banks will get accommodation at a higher rate, it is but natural that they will also charge a higher rate from their customers for granting credit to them. This lowers the demand for it.

Open market operations.

If the bank finds that its bank rate is not effective, it has the power of carrying out open

market operations. This means, it can purchase, sell or rediscount bills of exchange, etc., though they may not bear the signature of a scheduled bank or a provincial co-operative bank, purchase and sell sterling in not less than the prescribed sum, and make loans or advances repayable on demand, or on the expiry of the fixed period, not exceeding ninety days against certain forms of security. The joint-stock banks know it and never give a chance to the bank to do so, as they do not want it to enter into competition with them.

Q. 177. Describe the causes of a banking crisis. In what way and to what extent can the Reserve Bank be of help in a banking crisis in India? (*U. P. 1939*)

A. **The causes of a banking crisis.** A banking crisis occurs when people lose confidence in banks and withdraw money from them. It may be due to various causes. We have had a number of banking crises in this country. They occurred in 1829-33, 1860, 1865, 1913-17, 1922-34 and 1939. The first few crises were due to speculation and mismanagement. The crisis of 1913-17 took place because banks which conducted their business quite in violation of even the elementary principles of banking could not meet the huge public demands which arose due to the lack of confidence in them as a result of, in many cases, European War. The latter banking crises took place, however, more due to economic depression. The Alliance Bank of Simla failed in 1922, the Tata Industrial Bank in 1923, and the Peoples Bank of Northern India in 1932. The Benares Bank and the Quilon Bank failed

Loss of confidence.

Speculation and mismanagement.

Violation of elementary banking principles.

Economic depression.

in 1939. In fact, a banking crisis due to economic depression is a crisis which can be explained. First of all, there is a boom period when there is a good deal of inflation and rise in prices. Due to over-production, prices fall and people take a pessimistic view. Banks also do not accommodate their customers and they fail, bringing about the failure of the banks in their turn. In fact, physical, psychological and monetary factors all combine to bring about a banking crisis.

Boom and depression periods come in succession.

Physical, psychological and monetary factors.

The help that the Reserve Bank of India can give. The Reserve Bank of India has been designed to check banking crisis. Firstly, it can look to the general tone of banking, Secondly, it does not allow the banks to be reckless in their credit policy. A compulsory deposit of 5 % and 2 % of their demand and time liabilities respectively by all the scheduled banks is required to be maintained with the Reserve Bank of India with the same purpose in view. The Bank is also prepared to grant credit to scheduled banks to the extent desirable in conformity with their position. It has power to issue notes to a considerable extent against the security of government papers and certain kinds of bills. In fact, it is in these that the banks invest their funds. When in need of liquid resources, they can hand them over to the Reserve Bank in exchange for the required currency.

Improvement in the general tone of banking.

Checking of reckless credit expansion.

Granting credit to banks in conformity with their position.

Q. 178. State the functions which the Reserve Bank of India discharges to the Government of India and to the other banks.

A. **Functions discharged by the Reserve Bank of India to the Government of India.**

The following are the functions which the Reserve Bank of India discharges to the Government of India :—

(*i*) It holds the balances of the same free of charge. The amount held by it on this account may be found out from its weekly balance sheet of the Banking Department. **Holds all balances.**

(*ii*) It also undertakes the collection business of the Government of India, and does not charge anything for it. All receipts of various taxes, etc. on behalf of the same are received by it. **Collection business.**

(*iii*) The bank makes all payments too on behalf of the Government. Cheques issued by the same are paid by it out of the Government balances held. **Payment on behalf of the government.**

(*iv*) It manages public debts and advises the Government as to the suitability of the time with regard to their floatation. **Management of public debt.**

(*v*) The Government of India remits every year a huge sum to the Secretary of State for India in connection with what are known as 'Home charges'. The bank purchases sterling for the same. **Purchase of sterling.**

(*vi*) The bank advises the Government of India on various financial matters. It makes recommendations in connection with the banking legislation of the country. **Adviser on financial matters and banking legislation.**

(*vii*) It also grants credit to the Government in times of need. These are, however, for a comparatively short period. **Granting of short-period credits.**

Functions discharged by it to the other banks. The following are the functions which it discharges to the other banks :—

It guides, supervises ***and controls them.***

(*i*) The bank guides, supervises, and contro the activities of other banks. This function *in fact, of great importance for the sound develop ment of banking in any country.*

It keeps their reserves

(*ii*) It keeps free of interest the reserves o other banks. Scheduled banks are, in fact, re *quired to maintain with it a compulsory deposi* to the extent of at least 5% of their demand and 2% of their time liabilities. It may be mentioned here that centralised reserves are of a far greater utility than scattered reserves are. They can be moved very easily and effectively to meet a crisis in the land.

It acts as a lender of last resort.

(*iii*) Before the establishment of this bank, there was no institution to provide funds to the banks of the country with the result that in times of crisis many banks failed. Now, they can be supplied with funds to any extent provided they have got sufficient assets of the kind that can be pledged or re-discounted with the Reserve Bank of India.

It affords remittance facilities.

(*iv*) The bank provides to the other banks remittance facilities. It issues bank drafts payable at its own offices or agencies for this purpose.

Rediscounting.

(*v*) Its establishment has also facilitated the granting of loans to their customers by other banks to an appreciable extent in connection with their day to day business as the bills discounted by them can be rediscounted with it.

Clearing arrangement.

(*vi*) It gives to them facilities for clearing their cheques by acting as a clearing banker in important places of the country. The banks in this way settle their claims against one another

without transferring hard cash between themselves.

(*vii*) It purchases and sells sterling at 1*s*. $6\frac{1}{8}$*d*. and 1*s*. $5\frac{29}{32}$*d*. from and to them respectively but not less than in amounts of £10,000. This helps them in the financing of foreign trade of their customers and the transference of money from and to foreign countries.

Purchases and sells from and to them sterling.

Q. 179. What were the causes which led to the establishment of the Reserve Bank of India? Discuss its influence on Indian Banking.

(*U. P. 1943*)

A. For an answer to the first part of the question, please look to the answer to Q. 168.

Influence of the Reserve Bank of India on Indian Banking. Reserve Bank of India has its influence on Indian banking in various ways. First of all, its monopoly of note-issue gives it the power to influence the volume of cash and credit in the country. It is also the sole channel for the intake and outtake of other forms of currency as well which also go to make up the volume of cash. The volume of credit, in its turn depends upon the volume of cash, and hence it may be said that by having an influence over the volume of cash, it has got an influence over the volume of credit as well. Besides, credit is manufactured by banks, and these being under its control, it can have influence over their manufacture of it in various other ways. No doubt, indigenous bankers are not under its control but they do not manufacture credit to any appreciable extent, loans granted by them being usually cash loans. The Reserve Bank is, however, under the influence of the Govern-

ment and hence it influences the volume of cash and credit in the country according as the Government likes and it is not necessarily always in accordance with demand.

Next, it has its bank rate. In other countries rates of interest in the markets bear a direct relation with their bank rates. In India, however, this does not seem to be so. Since the inauguration of the Reserve Bank, conditions have been easy in the money market. We cannot, under the circumstances, say how far they would depend upon the bank rate when there is brought about a change. Even now, indigenous bankers charge a very high rate of interest which does not bear any relation to it. In fact, they do not depend upon Reserve Bank for granting loans to their customers. They carry on their loaning operations with the help of their own resources. Joint stock banks have also not felt the need for accommodation so far, and hence they also seem to work independently of the Reserve Bank. It is, of course, prepared to rediscount their bills and hundis at the bank rate, but bills and hundis do not arise in this country to any appreciable extent. Scheduled banks are, of course, required to deposit with it a fixed percentage of their demand and time liabilities, but it being very low, they can manage to go on smoothly.

The bank is also entitled to carry on open market operations. But it has so far never felt the need for using this weapon as well, and in the absence of an experiment, we cannot say how far it would be able to use it successfully if and when need be.

It is meant to exercise pressure on individual

banks in favour of better banking policies and practices and for this purpose it has laid down in its Memorandum dated the 7th December, 1938, on Discounts for and Advances to Scheduled Banks that in extending its credit to them it will take into consideration not only the nature of the security offered to it but also the general character of the investments of the applying bank, the manner in which its business as a whole is being conducted, whether for instance it offers excessively high rates of interest in order to attract deposits, whether it seeks help from the bank in normal times when the funds in the money market are ample and whether it has been overtrading and extending an undue amount of credit for speculative purposes in commodities or securities or indulging in unsecured business to an excessive extent. This is bound to have its effects in due course.

It is an adviser to the Government of India and various other governments in the country in matters of legislation concerning banking. Various Acts enacted recently in different provinces in connection with the regulation of money-lenders and their business have come in vogue mainly as a result of its recommendations. It has also made proposals for a Bank Act which will be enacted as soon as normal conditions return after the war. In the case of a number of enactments concerning the matters arising out of the difficulties of war, its influence has been supreme. It advises the various governments of the country with regard to their financial policies and through them influences Indian banking considerably.

It has made certain proposals for the linking of the indigenous bankers with its ownself and

it is possible that this may be brought about in due course. In case it so happens, Indian banking is bound to witness revolutionary changes.

It is on account of its recommendation that the scale of stamp duties on usance bills has been revised. Actions like these may in the long run be successful in developing a bill market in the country.

Q. 180. In what respects is the Reserve Bank of India the bankers' bank? What is its relationship with the indigenous bankers?

(Calcutta, 1937)

A. An answer to the first part of the question can be given with the help of the answer to the second part of the Q. 178.

Relationship of the Reserve Bank with the indigenous bankers. The Reserve Bank has got no relationship with the indigenous bankers as such. It has, however, made its own proposals for doing this. But as they were not acceptable to the indigenous bankers, no legislation has been recommended on their basis as yet. It is prepared to extend its open market operations to trade bills in the same way as it does at present to Government securities, provided an open bill marked is developed in this country by the indigenous bankers. It gives remittance facilities to approved indigenous bankers and charges the same rates as to non-scheduled banks and co-operative societies and banks. They are as follows :—

Upto Rs. 5,000	1/16%	(minimum Re. 1)
Over Rs. 5,000	1/32%	(minimum Rs. 3-2)

Actual telegram charges to be charged in addition.

Q. 181. What are the functions of the Reserve Bank of India ? What proposals has the bank made to bring the indigenous bankers within its ambit ? (Allahabad, 1943)

A. For functions of the Reserve Bank of India, please consult answer to Q. 172.

Proposals made by the Reserve Bank to bring the indigenous bankers within its ambit. The Reserve Bank of India's proposals to bring the indigenous bankers within its ambit may be studied under two heads : (1) Those contained in the letter addressed in May, 1937 to the Scheduled Banks and Shroffs' Association, and (2) those contained in the Statutory Report with a view to bring about development of a bill market in the country through them.

The proposals contained in (1) were as follows :—

(*i*) Indigenous bankers must confine their business to banking proper as defined by the Indian Companies Act. Any other business that they might be conducting should be wound up within a reasonable time.

(*ii*) They must maintain proper books of accounts, and have them audited by registered accountants. The Reserve Bank will have the right to inspect the accounts and call for any information necessary to determine the financial status of the banker.

(*iii*) They must file with the Reserve Bank the periodical statements prescribed for scheduled banks. They must also in the interest of their

depositors, publish the returns, prescribed for banking companies by the Companies Act and be liable to the same penalties for non-compliance.

(*iv*) The Reserve Bank will have the right of regulating the business of the bankers on banking lines, when necessary.

(*v*) During a period of five years from the date of their registration as private bankers in the books of the Reserve Bank, they will be entitled to open an account at any of the offices of the Reserve Bank, and be otherwise subject to the same conditions as the scheduled banks except that during such period they will not be required to furnish the compulsory deposit set out in section 42 of the Reserve Bank Act, unless any of their weekly statement discloses that their demand and time liabilities are five times more in excess of their capital in the business.

(*vi*) If an indigenous banker does not incorporate himself under the Companies Act, his liabilities in respect of his banking commitments will be unlimited. He should, therefore, state the amount of capital he has available for banking business. (Bankers with a capital of less than two lakhs need not apply).

(*vii*) When required they will have to indicate (*a*) the names and the extent of the interest of their business partners, if any ; and (*b*) if any of the bankers is a member of a Hindu joint family the names and interests of the co-sharers. In both the cases, statements will also be required to be made by the co-sharers that they are prepared to take lheir full share in the business and its liabitities.

(*viii*) This scheme will be a tentative one for a term of five years, but before the end of this period, the Reserve Bank will frame proposals for legislation if it thinks fit, further to co-ordinate or regulate the position of the private bankers. It is likely that such legislation would take the form of a separate Bank Act as suggested by the Banking Enquiry Committee or otherwise to standerdise and co-ordinate the status of these registered private bankers on lines in consonance with the scheduled banks.

(*ix*) (1) If they satisfy the above conditions, they will have the privilege of rediscount with the Reserve Bank against eligible paper, the right to secure advances against government paper, and remittance facilities similar to those for scheduled banks.

(2) If the Reserve Bank decides to take action on the lines here indicated, legislation will be necessary and the indigenous bankers will then be called upon to make an application in the manner which may then be prescribed.

Those contained in (2) were made as a result of the appreciation of the Reserve Bank of the point of view of the indigenous bankers which they put before it in reply to the above proposals. It was inclined to think that the ultimate solution lay in the development of an open bill market in which first class bills are freely negotiated. If such a market could be developed, it would be possible for the Reserve Bank, as it pointed out, to extend its open market operations to trade bills as it does at present to government securities and this would surely give first class indigenous bankers the closer and possibly ultimately the

direct relationship without compelling them to modify the essential character of their business or to submit to unduly rigid restrictions.

Q. 182. Write a note on the Rural Credit Department of the Reserve Bank of India. State the proposals of the Reserve Bank authorities for improving the rural credit facilities in India.

(Allahabad, 1940)

A. **A note on the Rural Credit Department of the Reserve Bank of India.** The work of the Reserve Bank of India is divided in different departments and that of each department in its turn, in different sections. The Rural Credit Department has three sections, *viz.*, the Agricultural Credit, the Banking, and the statistical and Research.

The activities of the Agricultural Credit Section are three-fold. First of all, it studies all problems relating to rural finance with particular reference to co-operation and to legislation for the relief of rural indebtedness. Secondly, it keeps in close touch with the co-operative movement through its officers who study on the spot its special features all over the country. The results are published in the form of bulletins. Thirdly, it places its services at the disposal of the central and provincial governments, co-operative banks and other banking organisations which may happen to consult it on problems connected with agricultural credit.

This section has so far prepared and issued a Preliminary Report and a Statutory Report, a draft scheme for the linking of indigenous bankers with the bank and several bulletins. Various Acts passed by the Provincial Legislatures with

regard to money-lenders, and their business were, it may be said, based on the suggestions contained in the two reports mentioned above. The reduction of the stamp duty on bills has also been brought about due to its efforts.

Next, it should develop a bill market in the country. At present the bank charges the same rate for its loans and discounting. This section should impress upon it the necessity of charging a slightly higher rate for its loans than for discounting. Further, it should impress upon it the necessity of encouraging the shroffs and other urban credit agencies by various means to finance the village bankers by means of usance bills. In case of financing the cultivators as well, the village bankers can be made to adopt the system of drawing such bills with dates of maturity approximately coinciding with the probable date on which the harvest would be sold, because they can only meet their bills with the proceeds of the sales. The bank like all other central banks has also got the power of carrying on open market operations, *i. e.*, direct dealings with those actually engaged in trade and industry in cases of emergency. But this section shall have to impress upon it the necessity of carrying on such operations through direct purchase, sale and discount of bills at least during the first few years, more freely and more as its normal power than emergency. In fact, for fostering the bill habit among the Indian population, it should have direct relations with the rural credit agencies, *e. g.*, money-lenders, indigenous bankers, co-operative societies and central banks and land mortgage institutions. Next, this section should maintain staff for audit and valuation

in the light of the suggestions already made. This will bring about efficiency in the working of both co-operative and land mortgage banks. Thirdly, it should get the Bank Act so amended as to bring the co-operative banks of the Native States of the country as well within its scope. At present, they remain outside it. Fourthly, it should study the problems of the Loan Offices of Bengal and Nidhis and Chit Funds of Madras and take steps to reform their working with a view to make them more useful credit agencies. Fifthly, it should impress upon the bank the necessity of dealing directly with those of the central co-operative banks as well which have reached a high standard of banking. Finally, it must establish warehouses on the lines suggested in connection with the marketing finance. By doing all these things, the section will prove to be of immense benefit in solving the problem of agricultural finance.

The Banking Section deals with all problems relating to the scheduled and non-scheduled banks, renders advice on banking and financial matters to banks and governments, and prepares reports on these matters as and when required.

The statistical and Research Section, on the other hand, studies various statistics and compiles them. It also undertakes researches on various problems.

Proposals of the Reserve Bank authorities for improving the rural credit agencies in India. In fact, Reserve Bank authorities have not made any concrete proposals for improving the rural credit agencies in India. The most efficacious method of developing new channels of

credit they believe to be found out by tentative experiments. They issue from time to time bulletins and circular letters laying down such general principles as seem to them to be of general applicability and offer advice for correcting errors which seem to them to be due to lack of knowledge or experience. From what is given in their Statutory Report, it seems that they want to see co-operative banks and indigenous bankers to be placed on all fours with scheduled banks. But they have also recognised that they are not yet ripe for this and that to insist on their furnishing compulsory deposits at present would be unduly harsh. With a view to bring about the development of a bill market in the country, they have, however, got stamp duties on bills reduced. Next, with a view to improve banking in India they have also made proposals for an Indian Bank Act. Their consideration has, however, been postponed because of the war conditions for the time being. They have also been in personal touch with the co-operative societies and banks and land mortgage banks. In certain cases, they have recognised them, published the reports in the form of bulletins with a view to make them available to others for improving their activities on the lines suggested, if possible.

Q 183. Attempt a lucid essay on the working of the Reserve Bank of India. (*Calcutta, 1939*)

A. **A lucid essay on the working of the Reserve Bank of India.** The Reserve Bank of India has been working for about 8 years. During this period, its bank rate has remained unchanged at 3 per cent. and all demands of

currency during busy seasons have been met by a reduction of the notes held in the Banking Department. The extent to which this is done can be measured by the difference between the maximum and minimum of them held by it. It has been much more than the average seasonal difference of Rs. 12 crores in the cash balances of the Imperial Bank in the pre-depression period of 1921-29. But there is the other side of the picture as well. Various rates in the markets do not seem to bear relationship with the bank rate. The money-lenders and indigenous bankers continue to charge usurious rates. The bank has, in fact, not been able to solve the problem of rural finance.

It has also been created with a view to minimise bank failures. But it could not rise to the occasion when Benares Bank, Ltd., and Travancore National and Quilon Bank, Ltd., failed in 1938. They were both scheduled banks, and their failure cannot but bring disreputation to the name of the bank. In the case of the latter bank at least, the position that it took was not justifiable. A little before the suspension, the bank in question had applied for aid, but it had been refused because the Reserve Bank insisted on an investigation before giving such aid. It may be said that the proper time to investigate was not when it was actually gasping for breath but during the preceding three years when it was on the list of the scheduled banks.

It has not been able so far also to bring indigenous bankers under its control. From the proposals contained in the draft scheme prepared by it for establishing a relation with them, it

is evident that it insists upon their receiving deposits, giving up of non-banking business and publishing of accounts. None of these things is possible. First of all, there is no need for its insistance upon their developing deposit business, when they perform many of the other banking functions. In fact, we cannot understand why should so much stress be laid out only on this function on the lines of the English banking system. Can India not follow the system evolved after an experience of centuries ? With regard to their giving up of non-banking businesses, also it may be said that many of them feel that the stoppage of a non-banking ancestral business would involve not only the closing up of a lucrative source of income, but might be a blow to their prestige as well. Then, with regard to the publishing of accounts also, it may be said that this is not so very necessary. It will serve the purpose if they send them periodically to the Reserve Bank of India which may publish it in a consolidated form if need be.

The bank has not also been able to develop a bill market in this country. It has, of course, brought about a reduction in stamp duties on them. Certain other measures are, however, required to be adopted before any success can be expected to be achieved.

But it has done a number of things and it may be hoped that it will go on improving. All the scheduled banks bear a close relation to it. Even non-scheduled banks have also been coming in touch with it. It has also been giving sound opinions with regard to various problems arising in connection with banking and finance in the

country to various governments and authorities concerned. It has also made proposals for the enactment of a separate Indian Bank Act.

Finally, there is collection and diffusion of banking statistics, etc. The bank prepares and transmits to the central government a weekly account of its. Issue and Banking Departments which is published in the Gazette of India. It publishes each week a consolidated statement of the returns received from the scheduled banks. It supplies to the press communiques regarding treasury bill sales, clearing house figures. government loans, etc. It has also now taken over the compilation of the Annual Report on Currency and Finance, and of the Statistical Tables relating to Banks in India. Finally, it publishes a monthly statistical summary and its Annual Report.

Q. 184. How would you improve the working of the Reserve Bank of India ?

(Calcutta, 1940)

A. **Ways to improve the working of the Reserve Bank of India.** The working of the Reserve Bank of India can be improved, first of all, by bringing its control in the hands of the people of this country. Of course, we know that the Government has wide powers in this respect. But so long as it is not responsible to the Legistatures, it cannot be expected to work in national interests.

The fixing of the exchange rate of the rupee between 1*s.* $5\frac{49}{64}$*d.* and 1*s.* $6\frac{3}{16}$*d.* against popular opinion can be cited as an example.

Modern banking being in its infancy in this

country, some of the provisions of the Act also do not conform to its requirements and hence they need change. With regard to the financing of agriculture, it may be pointed out, for instance, that loans and advances granted by it are required to be repaid within ninety days of their contration. Now, this cannot help agricultural operations in any large measure. They may, however, be used by the provincial co-operative banks or central land mortgage banks declared to be provincial co-cperative banks only for meeting temporary shortage of their funds provided they are sure of being repienished within this period. But it is obvious that they can look to the bank only in cases of emergency and not normally. This is surely in accordance with the practice prevailing in other countries. But here there is also the need at least in the transitional period for the provision of normal finance as well. There is, of course, the provision for the rediscounting of the promissory notes of the central co-operative banks and drawn for financing seasonal agricultural operations or of the approved co-operative marketing or warehousing societies, and in both cases maturing within nine months, by the provincial co-operative banks. This is no doubt a bit helpful. But there is another difficulty, *viz.*, that as far as the promissory notes of the co-operative marketing or ware-housing societies are concerned, they cannot arise in any large number because, as we know, there are very few co-operative marketing or warehousing societies in this country. Finally, from all this it is clear that the Reserve Bank recognises only provincial banks and not central banks for giving accommodation. The agriculturists

obtain credit from primary societies which look to central banks. As the Reserve Bank grants credit only to the provincial banks, the central banks in their turn must obtain funds from them. This is really a very round about process and hence it would be better if the bank were to deal directly with such central banks as conform to a particular standard than with only provincial banks.

The working of the bank can be improved also by bringing about a development of the bill market in the country. Its bank rate like the bank rate of other central banks is the rate at which it is prepared to rediscount bills and hundis or grant loans on the basis of the first class securities. Emergence of bills can be encouraged here, however, only by making a distinction between the rates for rediscounting of bills and hundis and for granting loans on the basis of the first class securities. The former must be a bit lower than the latter.

It should also bring indigenous bankers under its control as early as possible as so long as it does not do that it cannot be said to be in the control of the entire Indian money market. In fact, there are two money markets in this country—one modern and the other indigenous—without any connection between them.

Certain difficulties were also experienced in the interpretation of the rules in the Reserve Bank Act when the question of helping the Travancore and National Quilon Bank arose when it was gasping for breath. The advances, as already pointed out, could be made under the rules on the security of bills of exchange and promissory notes matur-

ing 90 days after the date of purchase. Hence, it was contended that the demand promissory notes which the bank offered did not fall in this category. It was also held that the bills and promissory notes on which the bank was authorised to grant loans could be only these in whose support the documents of title to goods had been transferred to the borrowing bank and not the goods themselves. As we know, this is far from realities. Warehouses and consequently warehouse receipts do not exist in this country. In fact, there is something wrong with the Act itself and it is idle to prescribe such documents as a basis for central bank assistance.

APPENDIX

SUPPLEMENTARY QUESTIONS

Q. 1. Explain the principal functions of the Reserve Bank of India. (*Rajputana*)

A. Please refer to the answer to Q. 172.

Q. 2. What is the composition of the reserve of the Indian Central Bank ? How does it operate to maintain stability of prices ?

(*Rajputana*)

A. This question can be answered with the help of the answer to Q. 176.

OTHER BANKING ORGANISATIONS

Q. 185. Compare and contrast the work of a commercial bank with that of an industrial bank. How does India stand in regard to industrial banking? *(U. P. 1934)*

A commercial bank receives short term deposits and hence also makes short term advances.

An industrial bank receives long-term deposits and also grants long term loans.

Needs of an industrial concern.

A. **Comparison of the work of a commercial bank and an industrial bank.** There is a vast difference between the work of a commercial bank and an industrial bank. A commercial bank receives deposits withdrawable at will or after the lapse of a short period--usually not more than a year. This makes it necessary to make advances also for short periods. An industrial bank, on the other hand, receives deposits for long periods—never for periods of less than a year. Thus, it is in a position to make advances also for long periods. Industrial concerns require both long-term and short term finances. Usually, they get their initial block capital by means of private or public subscription. But, sometimes, it becomes difficult for them to be able to get investors willing to subscribe to all the shares issued by them before they are in a full working condition. They also require from time to time block capital for improvement and expansion. This, they secure by issuing debentures or more shares. But, until conditions become favourable for placing such issues in the market, they may have to approach some banking concern for it. Besides these two kinds of capital required by

them, they also require working capital. Industrial banks under-write the shares and debentures of the industrial concerns and take them up pending their final subscription by the public. They keep themselves in close touch with the industries of the country, and hence are generally in a position to advise the promotors as to the desirability of floating a new concern and expanding a going one. Commercial banks provide for short-term money—working capital. Sometimes, they give temporary advances also for effecting improvement and expansion in the going concerns as long as the conditions do not become favourable in the market to issue debentures and more shares. In our own country, they are, however, not always willing to do this.

Under-writing business.

Advisory functions.

Accommodation rendered by commercial banks.

Conditions in the country with regard to industrial banks. The country stands in a very poor position with regard to industrial banks. The first of the kind started here was the Tata Industrial Bank which was established in 1918. Then came several others in its wake. But they never assumed any importance. The Tata Industrial Bank also, which was the only industrial bank worth the name, had to be merged in the Central Bank of India within 5 years of its birth. The position with regard to them in the country is thus not at all satisfactory. Those of any importance at present are the Canara Industrial and Banking Syndicate, Industrial Bank of Western India, Karnani Industrial Bank, and United Industrial Bank.

Very unsatisfactory.

Q. 186. Write a critical note on Land Mortgage Banks in India. *(Rajputana 1941)*

A. **A critical note on Land Mortgage Banks**

They calter for long-term requirements of the agriculturists.

Three kinds of L. M. Bank

(i) Strictly co-operative.

(ii) Commercial.

(iii) Quasi-co-operative.

in India. Land Mortgage Banks play an important part in the supply of rural finance by catering for long term requirements of the agriculturists which arise out of the necessity of redeeming their past debts and improving their lands which they cannot normally repay in a short period. These banks are generally of three kinds :—(1) strictly co-operative, (2) commercial, and (3) quasi-co-operative. The first is an association of borrowers who raise credit by the issue of mortgage bonds bearing interest and made payable to bearer. It is meant for mutual help and is not organised for profits. The second is a joint stock bank which works for profit and declares dividends. The third is an association of both borrowers and non-borrowers with a share capital and a limited liability.

Banks of co-operative type in this country but in practice of quasi-co-operative nature.

First bank in Jhang.

Number very much limited even now.

The land mortgage banks organised so far in this country are of the co-operative type. But as they admit as members some non-borrowing individuals also with a view to attract initial capital as well as business talent organising capacity and efficient management, they may be regard as belonging to the quasi-co-operative type. The first of these banks was opened in Jhang in Punjab. Since then, a number of them have come into existence in several provinces. But both the number and size of these banks are too small to meet fully the requirements of Indian agriculture.

How to obtain working capital ?

The most important question in connection with the formation of the co-operative land mortgage banks in this country is that of obtaining their working capital The agriculturists are here too poor to purchase shares. Certain methods have, however, been suggested with this end in view. The most practicable of these is that of

raising share capital by deducting a small amount out of the loans made to the borrowers, *e. g.*, if a borrower requires a loan of Rs. 1,000, he may be given this sum on the security of land, but 5 per cent., of it may be deducted and thus shares of Rs. 50 may be issued to him. If necessary, Government may be required to advance an initial sum free of interest on condition that it should be repaid as soon as possible. But the larger part of the capital shall have to be obtained by debentures whose redemption may also be required to be guaranteed by the Government. It is also possible that they might have to be purchased in the beginning by it. Payment of interest on them may also have to be guaranteed in certain cases.

Re-payment of land.

The amount and period of the loan should be fixed according to the repaying capacity of the borrower. It must also be fully secured. Instalments of payment must be so arranged as to suit his convenience. The Central Banking Enquiry Committee was of the opinion that for a long time to come the resources of these institutions would be mainly required for enabling the cultivator to redeem his land and house from mortgage and to pay off his old debts. The question is why emphasis should not be laid on the intensive and extensive agriculture and their resources not be utilised with this end in view, as until it becomes paying, the redemption will be illusory.

Provincia land mortgage are necessary

Every province having primary and central land mortgage banks must also have a provincial land mortgage bank. For the time being, however, certain central land mortgage banks have been

Existing arrangement for loans by the Reserve Bank of India to these banks.

declared to be provincial co-operative banks under the Reserve Bank of India Act. These can obtain from it loans and advances for periods not exceeding 90 days against Government securities in case of emergency under section 17(4) (*a*) of the Reserve Bank of India Act. The Reserve Bank has kept itself in close touch with their working and has

Benefit of advice.

always given them the benefit of its advice whenever it was sought for.

Preparation of a note for their financing and its circulation.

A note was prepared on their financing and circulated to all the central land mortgage banks and the Registrars of co-operative societies of the respective provinces. This note suggested certain improvements in the system followed by them with regard to the floatattion of debentures and also with regard to their retirement.

An All-India bank is necessary.

The foundation of an All-India Bank has also been recommended.

Amendment of certain laws is necessary.

Finally, there is the need of amendments in certain laws prevalent in this country. It has often been suggested that the land mortgage banks should be given summary power of recovery by foreclosure and sale without the intervention of the Civil Court, subject to the safe-guard that the aggrieved party can question the action of the bank in the Civil Courts. The removal of impediments to the free transfers of land in certain provinces because of the existence of Land Alienation Acts is also necessary as the land mortgage banks cannot sell debentures unless land which is a security for these debentures can be sold freely in case of default by the borrower.

Q. 187. Write a note on the Provincial Industrial corporation as recommended by the Indian Central Banking Enquiry Committee for improving the industrial banking facilities in

India. Has any action been taken in this connection in any Province in India ? (Allahabad, 1940)

A. **A note on the Provincial Industrial Corporation for improving the industrial banking facilities in India as recommended by the central Banking Enquiry Committee.** The central and six of the Provincial Banking Enquiry Committees recommended the establishment of state aided industrial corporations by various provincial governments in their provinces. There was in the beginning a difference of opinion between these and the foreign experts who came here to help them. The latter favoured the establishment of an All-India institution. Mr. Subedar and some other persons also held this view. Weighty arguments were advanced from both the sides. Those in favour of provincial industrial corporations were as follows :— Recommended by the C. B. E. and six of the P. B. E. Committees. Foreign experts favoured an All-India institution

(1) Industry being a provincial subject, any scheme to promote it must be shaped and controlled by provincial governments. Provincial subject

(2) The financing of provincial corporations by their respective provincial governments will be easier than that of an All-India institution by the Central Government. Financing will be easier

(3) It will be easier for the provincial corporations to raise capital by appealing to the provincial patriotism than for an All-India institution. Corporations will be successful in raising capital.

(4) Provincial institutions are better fitted to understand the needs of the industries of their own provinces than an All-India institution to understand the needs of the industries in different provinces. They will understand better the need of their respective provinces.

Question of the employment of technical experts.

(5) As a corollary to (4) provincial institutions shall have technical experts concerning the industries of their own province, and will be able to employ them for whole time, while an All-India institution shall need technical experts concerning industries spread over the whole country and shall not be able to employ them for the whole time. Concentration will not be possible in the latter case.

The arguments advanced of an All-India institution were as follows :—

Financial position of provincial governments weak.

(1) The financial position of the provincial governments does not warrant them to take up the task.

Question of confidence.

(2) The issues of an All-India concern assisted by the Central Government will inspire a better confidence.

Advantages of the distribution of funds over a wide area.

(3) The funds of an All-India concern will be distributed over a variety of industries and a very wide area, and hence it will be able to pass through a difficult period of economic depression without any considerable risk.

It will wield a greater influence.

(4) An All-India concern shall have a greater voice in the enactment of laws affecting trade and industries in the country. It shall be able to throw a greater weight on the policy of the Government regarding tariffs railway rates and purchase of stores, all these being central subjects.

Question of staff.

(5) The staff of an All-India institution drawn from all over the country shall have a wider knowledge and a better understanding capabilities. Industries of one province shall be able to take advantage of the experience obtained in other provinces.

(6) There are vast resources lying unexploited. An All-India concern will select the most prominent projects in the beginning and postpone the less prominent for the future.

Possibility of a wider selection of resources.

But in the end, unanimity was obtained, and it was decided to have provincial industrial corporations with a central association to safeguard and promote the common interests. The functions of the latter were laid down as follows :—

In the end unanimity was reached.

(1) Assistance to provincial corporations to secure subscriptions from the public for their shares and debentures.

Functions of a central association.

(2) Co-ordination of their activities and checking any tendency on their part to give preference to certain industries over others.

(3) Laying down of certain general principles for their guidance.

(4) Securing for them concessions from the Central Government.

Action taken in this connection by various provinces. U. P. was the first to take action in this connection. A scheme for the floatation of a company of this type received the approval of its provincial legislature in June 1936. It contained the following provisions. The company may be called the Industrial credit company or Banking Corporation. Its subscribed capital may be about Rs. 30 lakhs, and its paid up capital about Rs. 15 lakhs. It may supplement its own capital by raising long-term deposits and loans. It may also issue debentures. It may have a Directorate of six or seven members, some of whom may be nominated. The Government's

The U. P. scheme.

sanction may be necessary for the appointment of the manager and other superior staff. The company may establish branches at mofussil centres and may set up local committees there. The Government may also assist it by guaranteeing dividend on capital at a specified rate or interest on debentures at a fixed percentage. It may also grant subsidy towards the expenses of management. A marketing company has also been started, and the credit company has underwritten its capital to the extent of Rs. 5 lakhs. It does not only market the goods on a consignment basis and do general commission work, but also makes small advances for raw materials or against finished goods left with it for sale. The Government assists it by giving an annual subsidy and contribution towards the cost of educative propaganda, publicity, advertisement etc. Several other provinces have also taken action on the same lines.

Q. 188. Have you any suggestions for improving the present banking facilities of India in respect of industrial finance ?

A. **Suggestion for improving the present banking facilities in respect of industrial finance.** A number of suggestions have been made for improving the present banking facilities of India in respect of industrial finance. First of all, Imperial Bank of India and other commercial banks and specially the strong ones can increase their financial assistance to the industries to a very great extent by adopting the following lines :—

I. B. and other banks can assist them.

(1) They must act as underwriters of all the issues whether of the new or old concerns. This

will necessitate the maintenance of an expert staff by them, which shall study very closely the future prospects of a company proposed to be started. It will have the effect of limiting the number of concerns which have no good future prospects. In fact, many of such companies could not have come into being as have failed due to lack of careful thinking, had this policy been followed by the banks and thus the ruin of a number of investors would have been saved.

Acting as under-writers.

(2) In most cases the issues under-written by the banks shall be readily subscibed to by the public as they will inspire a better confidence, but in certain cases, it is possible that a portion of the same might have to be taken by them. These will not, however, remain with them for a considerable time as the growing prosperity of the companies concerned will enable them to unload them soon in the open market and perhaps at a premium.

Subscribing to capital.

(3) The banks shall have also their representatives on the directorates of such companies and they will thus surely exercise a note of caution.

Appointing Directors.

(4) They must make short-term advances on the personal security of the companies to some extent.

Short-term advances.

(5) Licensed warehouses must be established in important industrial centres and advances should be made on the basis of the receipts issued by them.

Licensed ware-houses.

(6) Discounting of bills should be encouraged by charging a lower rate than for other forms of credit. This will provide the banks with the kind of the assets they need most. In their absence, they are in the habit of investing huge

Discounting facilities.

sums on the purchase of government securities and treasury bills. This is not the proper function of banks. They must, first of all, help industries and trade and then the Government.

Investment in industrial scrips.

(7) A large proportion of almost all the investments of these banks is in government securities, only a fraction being in debentures, stocks and shares of joint stock companies. In recent years, however, there has been a change in the attitude of most of them, and the proportion of their investment in the latter has been rising up. This is good and must be encouraged.

Establishment of industrial banks.

If, however, Imperial Bank and other commercial banks do not take up this task, more of industrial banks may be established to fulfil the gap, and in such a case their functions will be the same as laid down above. The existing industrial banks will also do well to improve their business on these lines and to become more useful to industries.

Recommendation of Banking Enquiry Committees and objections thereto.

Some of the central and six of the Provincial Banking Enquiry Committees have also recommended the establishment of state-aided industrial corporations by the provincial governments for this purpose. But this can be ruled out for certain well-known objections against it. First of all, the burden of establishment of such institutions will fall on the tax-payers who will certainly resent it. Next, if the governments have got funds to take up this task, there are many others which being more important must precede it. Thirdly, it is not reasonable that state aided institutions should be allowed to compete with private enterprise. But there is a case for their establishment for the purpose of undertaking the

financing of several public utility industries. Already the need for such an institution has been felt in some provinces. In the beginning, the foreign experts who came to assist the Banking Committee, however, insisted on the establishment of All-India institution for this purpose. Very weighty arguments were advanced from both the sides. But in the end unaniquity was obtained on this point, and both the sides being impressed by the arguments of each other, decided to have provincial industrial corporations with a central association to safeguard and promote the common interests.

Final scheme.

Finally, steps should be taken to popularise shares and debentures of the industrial concerns amongst the public. These include the examination of the schemes by the industrial banks before a new concern is floated, the inspiring of confidence of the public in them by the change in the policy of the Government, the creation of agencies capable of bringing the people in close touch with industrial securities, making arrangements for their education and training, the introduction of the firms of reliable share-brokers in all towns, the reduction of stamp duty on the transference of the securities, the encouragement of dealings in small units of shares, their acceptance by banks as security for granting loans, and avoidance of competition of the Government to raise capital in the Indian markets by offering high rates of interest.

Steps to popularise industrial scrips.

Q. 189. Enumerate the various banking functions performed by the Post Offices in India. Indicate the directions in which it is either possible or desirable to extend the banking services

of the Indian Postal Department. (*U. P. 1930*)

Four important functions.

A. **Banking functions performed by the Post Offices in India.** The various banking functions performed by the Post Offices in India are (1) the acceptance of deposits in savings banks, (2) the issue of postal cash certificates, (3) the purchase and sale of Government securities, and (4) the issue of Life Assurance Policies. We have certain miscellaneous services as well.

History.

Savings Banks. Post Office savings banks were first established in 1882 and since then they have been making gradual progress excepting temporary setbacks during the war periods (1914-18) and (1939 to date). These banks are found throughout the country in all head post offices, all sub-post offices and some branch post offices.

Statistical informations.

Their number is about 13000, and more than 31 lakhs of people of all sorts have deposits in them of an amount aggregating to about Rs. 52 crores. Net deposits into an account in a single year have been now raised to Rs. 1,500 and the total amount that can be kept in it is limited to Rs. 5,000 in the case of an adult and to Rs. 1,000 in the case of a minor on whose behalf an account can be opened by his relative or guardian. Withdrawals can be made once a week.

Calculation of interest.

The rate of interest is at present 1½% and it is calculated for each month on the lowest amount in an account between the end of the 4th day and the end of the month. The acceptance of cheques as well in savings bank transactions has been allowed since 3rd August, 1942. As a war measure Post Office Defence savings banks accounts have also been introduced from the year 1941-42. The amount standing to the credit of these accounts

at the end of the year 1942-43 was Rs. 40 lakhs. Withdrawals from them will be allowed after the end of the war. The rate of interest on them is 2½ per cent.

Suggestions for improvement. It would be better, if the number of post offices performing savings bank business is increased. There is a great necessity of these post offices in rural areas. In small villages where the employment of a full time post-master may be thought to be unprofitable, some important people may be authorised to carry on this business on behalf of the post office. They should be made responsible to the postmaster of the neighbouring post office with whom they must deposit all sums, say after retaining Rs. 20 in their hand. The communication between such persons and the neighbouring post offices may be maintained through the postmen. Deposits by cheques on other banks have already been allowed. Withdrawals by cheques may also be allowed without any difficulty as they have been allowed by many joint stock banks. Besides, at present amounts cannot be transferred from one savings bank account into another. The facility can be given with ease. Use of the languages most current in various provinces will also go a long way to popularise them. These are some of the suggestions in connection with the extension of this business.

Number ought to be increased.

A scheme for tapping rural areas.

Withdrawal by cheques.

Transference from one account into another.

Use of Indian languages.

Postal Cash Certificates. Issue of postal cash certificates was first begun during the war of 1914-18. It has succeeded in drawing out a considerable amount of the savings of persons of moderate means. The certificates mature

Their nature.

after 5 years from the date of issue and are payable in Rs. 10 or multiples of Rs. 10. The difference between the purchase price and the maturity yield provides interest. They can be cashed at any time before maturity, but no interest is paid if they are cashed within a year from the date of issue, and interest rate rises progressively from the second year. From their inception till the year 1935-36, there was registered an annual increments in the amount standing at the end of each year. Since 1936-37, however, there has been brought about a decline. At the end of the year 1942-43, total amount outstanding was Rs. 34·57 crores. As a war measure Ten Years Post Office Defence Savings Certificates have also been introduced. Their amount standing at the end of the same year was Rs. 5·56 lakhs.

Conditions of their purchase, sale and custody.

Purchase and sale of Government Securities. The facility provided for the purchase and sale of Government securities by the post offices is also very important. An individual can invest money free of charge through a post office in any Government of India securities upto a maximum of Rs. 5,000 in any official year. These can also be sold through it free of charge at the prevailing prices if the investor is a savings bank depositor at the time. An investor can also leave the securities purchased through a post office in the custody of the D. A. G. of Posts and Telegraphs. It has been pointed out by some that a greater publicity should be given to this facility provided by the post offices so that the public may know of it.

Greater publicity needed.

Insurance business. Insurance facilities

are provided by the post offices to Government servants, and employees of local bodies and Universities. They are life assurance and endowment assurance. There is also a special kind of insurance wherein monthly allowances commencing at once or from a particular date in future are given. The minimum and maximum limits of the first and second kinds of policies are Rs. 100 and Rs. 20,000 respectively, and those of monthly allowances are 8 as. and Rs. 50. The premia is deducted monthly from the salary. It has been suggested by some that this facility should be extended to the general public. This will, however, be injurious to the interest of the insurance companies, as people would prefer postal insurance to private insurance.

Conditions governing this kind of business.

Its extension to other than Government servants undesirable.

Miscellaneous services. The post-office also collects money for the parcels sent through it under V. P. P. system. It is advantageous for promoting transactions between those sellers and purchasers who are not known to each other. It also undertakes the remittance of money under money order system. The rate of commission is very high, Re. 1/- per cent. It may be lowered with advantage. There are many places in the country where there is no other agency to undertake this business.

V. P. P. system.

Money order system.

APPENDIX

I

SUPPLEMENTARY QUESTION

Q. 1. What is the difference between the func-

tions of an Industrial Bank and that of an ordinary commercial Bank? What help can Indian industries expect from the establishment of Industrial Banks in our country? (*Rajputana*)

A. Please consult answers to *Qs.* 186 and 189.

CHAPTER XXIV

SURVEY OF INDIAN BANKING

[FUNCTIONS OF THE DIFFERENT CLASSES OF BANKS—DEFECTS AND REMEDIES—EFFECTS OF THE LACK OF DISCOUNTING FACILITIES ON INDIAN MONEY MARKET—SPECIAL FEATURES OF INDIAN BANKING—CAUSES OF THE SLOWNESS OF THE DEVELOPMENT OF BANKING HABIT].

Q. 190. Enumerate the different classes of banks in India, stating briefly the differences in their functions. (*Rajputana*)

A. **Different classes of banks in India.** The different classes of banks in India are (1) the Reserve Bank of India, (2) the Imperial Bank of India, (3) the Exchange Banks, (4) the Joint Stock Banks, (5) the Land Mortgage Banks, (6) the Co-operative Banks, (7) the Industrial Banks, (8) the Savings Banks, and (9) the Indigenous Bankers.

Reserve Bank of India.

Not allowed to compete with other bank.

(1) The Reserve Bank of India is the central bank of the country. It performs both the central banking and ordinary banking functions. The latter have, however, been so designed as to be performed by it in a way that it may not be possible for it to enter into competition with other banks of the country. For instance, the bank receives deposits but free of interest, discounts bills of exchange, etc., but bearing signatures of at least one of the scheduled banks or of a provincial co-operative banks. It grants credit only

to various Governments, States, local authorities and scheduled and provincial banks. Its central banking functions are the same as those of any other central bank. It has the sole monopoly of note-issue, and it is the sole channel for the in and outtake of all currency. It is a banker to the various Governments in the country, holds their balances, manages public debts, receives and pays on their behalf in India and abroad. It is also a banker's bank. Every scheduled bank has to maintain a fixed percentage of its time and current deposits with it. The bank helps them in times of need. It guides supervises, and controls them. It also collects and publishes various statistics regarding banking in this country.

Central banking functions.

Imperial Bank of India.

Agent to the R. B.

Commercial and exchange business.

(2) The Imperial Bank of India is a bank of its own kind. In no other country of the world, we have a parallel to it. It acts as an agent to the Reserve Bank of India. Besides, it undertakes all the commercial banking functions. It has also been now allowed to undertake foreign exchange business.

Exchange banks having monopoly of exchange business.

Under-take com. banking business as well

(3) The Exchange Banks are the banks of foreign origin having branches in this country. They have monopolised almost the whole of the foreign exchange business. For sometime past these banks have also begun doing commercial banking business. They have got their offices at port towns and big commercial centres.

Joint stock banks undertaking com. banking business.

(4) The Joint Stock Banks are the banks registered under the Joint Stock Companies Act of the country. They undertake all kinds of commercial banking business.

(5) The Land Mortgage Banks are the banks established in certain provinces to finance the

long-term needs of the agriculturists. They receive deposits for long terms and hence are in a position to undertake this business. They do it on the mortgages of the lands belonging to the borrowers.

Land mortgage banks meeting long-term needs of the agriculturists.

(6) The Co-operative Banks are the banks established with a view to finance the short-term needs of the agriculturists. There are, however, some banks which finance the short-term needs of borrowers belonging to other classes but their number is not big enough. These banks have been found on co-operative principles.

Co-operative banks meeting their short-term needs.

(7) The Industrial Banks are meant to finance the long term needs of the industries other than agriculture. Their number is, however, very small. They also receive long-term deposits, hence are in a position to lend for long periods.

Industrial bank financing industries.

(8) The Savings Banks in this country do not have any separate existence of their own. This business is, however, being done in fact by the post offices and some of the above banks. They are meant to encourage thrift among the people in service.

Savings banks business the post offices.

(9) The indigenous bankers consist of the individuals and partnership firms doing banking business on the most antiquated lines. In most cases it is a side business of theirs. They are spread all over the country, and finance a considerable portion of the inland trade of the country. Besides, they also finance the cottage industries, and in some cases also the factory industries to a certain extent.

Indigenous bankers and their functions.

Q. 191. What are the principal defects of banking in India? What remedies do you suggest to remove these defects? (*Rajputana*)

A. The following are the principal defects of banking in India :—

Development unsatisfactory.

(1) It is not sufficiently developed. The number of the modern banks is very small. Out of 2500 towns in the country hardly 1000 possess a modern bank. This stands in no comparison with the state of affairs in other countries.

Catering only for short-term business.

(2) Most of the banks in this country transact only short-term business. The Imperial Bank, the Joint Stock Banks, and the Exchange Banks, all advance money for only short-terms and against easily realisable securities. The number of the Land-Mortgage banks, and Industrial banks is very small.

No development of banking habit.

(3) Banking habit has not been developed amongst the people. They still hoard bullion. This is, in fact, due to the lack of confidence in the currency and banking system of the country. Rupee currency and notes are token coins, and banks fail almost in every banking crisis.

Two systems of banking without any co-ordination between them.

(4) It is not at all organized. In fact, there are two systems of banking in this country—the modern and the indigenous with no connection between them. The modern banks are, however, somewhat under the control of the Reserve Bank of India since its establishment. But the indigenous bankers are still out of its control, and various schemes suggested for the same, have not as yet materialised. Again, neither the modern banks, nor the indigenous bankers have any sympathy with one another.

Two money markets with quite opposite

(5) With two different units of banking there are two different money markets in the country. Discount rates in one do not affect the discount rates in another. It has been generally observed

that while modern banks do not find employment of their resources, even at very low rates, indigenous bankers are hard-pressed for money even at very high rates.

tendencies prevailing in them.

Imitation of English banks.

(6) Indian banks have copied the chief features of English banks without even in the least thinking whether they suit the Indian conditions. As we know, there is a vast difference between India and England in the economic condition and problems. English people are well versed in financial matters and English industries have never felt the want of capital. Indians are, on the other hand, conservative and ignorant, and Indian industries are in the need of more and more of capital. The banking system should suit the existing conditions.

Management expensive.

(7) India is a poor country, and it cannot afford to have a system of banking which requires expensive buildings and high-salaried staff. Besides, European management and use of English language is another impediment to the development of the system.

Absence of a separate banking law.

(8) There is no separate banking law in this country. The Indian Companies Act applies to banking also. It, however, leaves much which requires regulation and control.

Lack of training.

(9) Sound and good banking depends upon efficient bankers. Trained Indians in banking are not available. Banking education is imparted only in a few universities and colleges and even this is far from being practical.

Branch-banking necessary.

The above defects can be removed and are being removed gradually. But the speed of reform is very slow. Branch banking will go a long way to increase the number of offices. A

Improvement of indigenous bankers desirable.

change of methods in the working of indigenous bankers will also do away with the necessity of opening of new branches of modern banks in towns which have at present got none of them, as there is no place in this country where we have not got an indigenous banker doing banking business. Then, a relation can be established between indigenous bankers and modern banks by bringing the former under the control of the Reserve Bank of India in accordance with the various schemes suggested from time to time. A change in the methods of working of the modern banks too is very necessary with a view to make them more suitable and useful for service in the country. Finally, spread of banking education and its reform will provide the country with suitable bankers, and banking law will check corruption.

Establishment of relation with R B.

Change in the methods of modern banks.

Banking education.

Q. 192. Discuss the principal defects of banking in India. Point out the effects of the lack of discounting facilities on Indian money market. *(U. P. 1943)*

A. For an answer to the first part of the Q. please look to the answer to the last question.

The effects of the lack of discounting facilities on Indian money market. The following are the effects of the lack of discounting facilities on Indian money market :—

Devoid of possessing legitimate assets.

(1) Banks do not have the advantage of possessing their most legitimate assets in the shape of short-term advances against goods represented by commercial bills. In fact, these are the only assets which are readily convertible into cash in an emergency.

(2) Bank's power of lending is not elastic. If there are bills with the banks, they can rediscount them which increases the balances of the banks with the Reserve Bank, and as the balances constitute their reserve, they can lend much more to their customers on the basis of the increased balances.

In elasticity of lending power.

(3) Finally, there is the absence of the automatic expansion and contraction of the note currency. The Reserve Bank of India is empowered to issue notes on the basis of the bills rediscounted with it. In countries where bill habit has sufficiently developed, supply of bills depends upon trade conditions. When business is brisk, more of bills are drawn and discounted, and when it is dull, new bills do not arise and old bills mature. Now, these bills are rediscounted by the banks at the central bank and currency expands according as it is required. In India, this is not possible under the present conditions though Reserve Bank of India has been established with necessary powers.

In elasticity of note-issue as well.

Q. 193. Explain the special features of Indian banking with a view to make suggestions for improvement. *(Calcutta, 1940)*

A. For special features of Indian banking with a view to make suggestions for improvement, please look to the answers to Q. 191.

Q. 194. Analyse the causes that have conduced to the slowness of development of the banking habit in the country.

Mention some of the factors that can be employed to improve the present position. (U. P. 1934)

A. **Causes of the slowness of the deve-**

lopment of the banking habit in the country. Various causes are assigned to the slowness of the development of the banking habit in the country. The first and foremost is that the greater part of the population of the country has a very scanty income which does not allow them to save anything. The agriculturists who form, in the main, the population of the country are heavily indebted. In many cases they are not able to meet both their ends. The condition of the middle class of the urban population is also far from satisfactory.

Scanty income.

It is said that whatever savings Indians have got lie hoarded underground. This may be due to the fact that there had been no peace and order in the country for long upto the middle of the past century. Besides, the foreign raiders down from Mahmud of Ghazni to Ahmad Shah Abdali, the Indian princes of the various localities waged wars against their neighbours and their soldiers robbed the people of whatever wealth they could get from them. The condition during the chaos that reigned in the country since the fall of the Moghul Empire till the establishment of the British Sovereignity was awfully bad.

Absence of peace and order in the country for long before the coming of the Britishers.

The best form of investment in this country has been for long investment in land, perhaps due to the security it affords and status it gives. Next to land, ornaments are the most popular form of investment. This is so, because they have always played an important part in social ceremonies sanctioned by religion or custom. In fact, there was absence of any kind of banking facility and this form of investment afforded not only safety, but also the best liquidity. The

Circumstances have forced the people to invest in landed properties and ornaments.

Hindu Law of Inheritance, which makes women ineligible for receiving any share of immovable property, has also led to the practice of giving *stridhan* to women in the form of ornaments at the time of marriage.

Numerous failure of Banks.

Some of the Indians took to depositing their savings with the modern banks of the country, but they came to grief due to their continuous failures. The whole history of joint-stock banks in the country consists of a series of banking crises. During the period 1933-34, not less than 342 banks failed here in India. Two of the banks have failed very recently, even when it was thought that there would be no failures because of the readiness of the Reserve Bank of India to help the banks in times of need. In fact, Indians have a greater confidence in Government than in these banks. This is shown from the fact that there was a huge balance in the post office Savings Bank accounts. They prefer investment in Government securities as well to the shares of joint stock companies.

Our currency system does not inspire confidence.

We have also got a currency system which does not inspire confidence. To an average Indian the value of a rupee coin seems to be the intrinsic worth of the silver it contains. Hence, he likes to hoard his savings in the form of precious metals than keep it in the form of rupee coins or invest it with the banks.

Establishment of savings banks and co-operative societies.

Suggestions for Improvement. The present position can be improved in different ways. More of savings banks should be opened in villages. There are in this country even now many places where there are no post offices and no facility of savings bank accounts. Establish-

Increase of national income.

Popularising savings banks.

Popularising use of cheques.

Opening of new share markets.

ment of co-operative credit societies too would go a long way to encourage thrift and savings. Above all, the national income should be increased. The postal department should give greater facilities to its depositors. It may allow withdrawal by cheques as well just as some of the joint stock banks doing savings bank business allow. Use of Indian languages in banks will also help much. The Government and other semi-Government institutions can popularise the use of cheques by making all payment in cheques. Then, there are very few share markets in the country. The investors in the up country towns feel difficulty at the time of selling their shares. It is a matter of great satisfaction that such markets have recently been opened in Cawnpore and Lahore.

APPENDIX

SUPPLEMENTARY QUESTION

Q. 1. What are the defects from which Indian banking system as a whole suffers? Suggest measures to improve the situation.

CHAPTER XXV

INDIAN MONEY MARKET

[ITS CONSTITUENTS—RELATIONSHIP BETWEEN THEM—FUNCTIONS OF EACH—SPECIAL FEATURES]

Q. 195. What are the constituents of the Indian money market? Indicate the exact relationship between them. (*U. P. 1931*)

Names of the different parties.

A. **The constituents of the Indian money market.** The constituents of the Indian money market are the Reserve Bank, Imperial Bank, foreign exchange banks, Indian joint stock banks, co-operative banks, and indigenous bankers and money-lenders on the one hand, and borrowers of money on the other. The borrowers of money include the Central as well as the Provincial Governments, States and other Government bodies.

Relationship between R B. and other constituents.

Relationship between them. The relationship between these constituents is becoming closer and closer with the establishment of the Reserve Bank. The Reserve Bank is a banker of the Government. It is also a banker of all the scheduled banks in the country. They comprise of Imperial Bank and almost all the foreign exchange banks, and Indian joint stock banks. The Reserve Bank of India also keeps itself in contact with the non-scheduled banks. The Registrars of joint stock companies send one of the copies of the balance sheets and Cash Reserve Returns received from these banks to this bank. It also gives advice to them on financial and banking matters and

most of them have welcomed it. Imperial Bank of India also acts as an agent of this bank.

The extent of accommodation it affords them.

The Reserve Bank of India rediscounts the bills of the scheduled banks and provincial co-operative banks. It also grants them credit against prescribed securities. The Secretary of State for India, the Governor-General, the provincial governments, local authorities and states also borrow from it in accordance with the terms of the Act. It performs agency work also for them. The Reserve Bank is willing to advise all the other constituents with regard to financial matters.

The relationship between I. B. and other parties.

The relationship between the Imperial Bank and the Indian joint stock banks is not of harmony. The Indian joint stock banks regard the entrusting of the sole agency business to the Imperial Bank and the payments to it by the Reserve Bank, particularly after the removal of the restrictions on its activities, as unfair to themselves. In fact, the Imperial Bank has now been enabled to compete with the other banks with the help of their own money kept as reserve with the Reserve Bank.

The relationship between exchange banks and J. S. banks.

The relationship between the foreign exchange banks and Indian joint stock banks is also not one of friendship. The former have opened their branches in inland towns also and compete with the Indian joint stock banks for deposits and other banking businesses. They have recently acquired interest in some of the Indian joint stock banks for deposits and other banking businesses. They have recently acquired interest in some of the Indian joint stock banks and compete with others with their help. They have monopolised exchange business and

do not let any other bank do it. In fact, they circulate all kinds of rumours against Indian joint stock banks. Managers of both these banks and Imperial Bank are Europeans, and hence they sympathise with one another but do not deal with Indian joint stock banks in a manner suitable to them. Though Imperial Bank has now been allowed to undertake foreign exchange business, it does not do so.

The Indigenous bankers.

The indigenous bankers form in themselves a separate unit. They discount their hundis with the Imperial Bank and other Indian joint stock banks only during busy season. These banks maintain a list of approved indigenous bankers and accommodate them to the extent determined on the basis of the informations regarding their position with them. The indigenous bankers have no connection with the Reserve Bank. It has, however, made certain suggestions with a view to enable them to be linked with it. But nothing has been so far done in this connection.

Co-operative Banks.

Provincial co-operative banks, as we have seen, get credit from the Reserve Bank. It also rediscounts their agricultural papers. They also maintain accounts with some of the Indian joint-stock banks. There are Central Co-operative banks also. They maintain accounts with some of the Indian joint-stock banks.

Q. 196. What are the constituents of the Indian Money market. Discuss their functions and indicate the relation between them.

(U. P. 1937)

A. For an answer to the first part of this question please refer to the answer to Q. 195.

Ordinary banking functions.

Their functions and relationship between them. The Reserve Bank performs both central banking and ordinary banking functions but the latter have been so designed to be performed by it as not to allow it to enter into competition with other banks of the country. For instance, the bank receives deposits but free of interest, discounts, bills of exchange etc., but bearing signatures. of at least one of the scheduled banks or of a provincial co-operative bank. It grants credit only to various governments, states, local authorities and scheduled and provincial co-operative banks. Its central banking functions are the same as those of any other central bank. It has the sole monopoly of note-issue, and it is the sole channel for the in and outtake of all currency. It is a banker to the various governments in the country, holds their balances, manages public debts, receives and pays on their behalf in India and abroad. It is also a bankers' bank. Every scheduled bank has to maintain a fixed percentage of its liabilities with it. The bank helps them in times of need. It guides, supervises and controls them. It also collects and publishes various statistics re: banking in this country.

Its central banking functions.

(i) The functions of I. B.

The Imperial Bank of India acts as an agent to the Reserve Bank of India. Besides, it undertakes all the commercial banking functions. It has now also been allowed to undertake foreign exchange business. The Indian joint stock banks also perform all the commercial banking businesses. The foreign exchange banks monopolise in foreign exchange business and finance the foreign trade of the country. But they also compete with the Indian joint stock banks for commercial

(ii) Indian J. S. Banks.

(iii) The foreign exchange banks.

business in important towns of the country. The provincial co-operative banks are meant to finance the central co-operative banks which in their turn finance the primary co-operative societies. The provincial banks also guide and supervise the central co-operative banks

(iv) The co-operative banks.

There are indigenous bankers also. They approach the Imperial Bank of India, and other Indian joint stock banks for finance, during busy season. They finance the whole of the agricultural industry and internal trade of the country. They use hundis, which they discount with the Imperial Bank and other joint stock banks when they are short of funds. They also obtain advances from the banks on cash credit basis against granaries and other kinds of stocks.

The functions of the indigenous bankers.

Q. 197. What are the constituents of the Indian Money market? Examine in this connection the relation of the indigenous banks with the Imperial Bank and joint stock banks.

(U. P. 1935)

A. For an answer to the first part of this question please refer to the answer to Q. 195.

The relation of the indigenous banks with the Imperial Bank and joint stock banks. The Imperial Bank and joint stock banks maintain a list of the approved indigenous bankers. They are prepared to do business only with these and to the extent laid down before the name of each one of them determined according as is their information regarding their financial stability. Normally, these indigenous bankers do not approach the Imperial Bank or the joint stock banks. They have their own capital and they carry on their business with it. It is only during busy

I. B. and Indian J. S. banks prepared to do business with indigenous bankers whose name appear on their approved list.

season that they approach these banks for accommodation. They discount their hundis with them and obtain advances on cash credit basis. The Imperial Bank of India and other joint stock banks have got their offices in Indian mandis. Some of them have their pay offices even in petty towns provided they are important mandis. Through these offices, they advance money to the indigenous bankers on the securities of the grains. There are granaries and the keys of these are handed over to the banks at the time of taking advances from them. According as they are repaid, these granaries are relieved from the custody of the banks.

Q. 198. Discuss the special features of the Indian money market. *(Calcutta, 1938)*

A. **Special features of the Indian money market.** The following are the special features of the Indian money market :—

(1) **Absence of a well-knit organised money market.** There is no one well-knit organised money market in this country. In fact, there are two sides of it, *viz.*, the modern and the indigenous, each without any control of the other. The Reserve Bank of India which is the premier bank of the country should have control over indigenous bankers as well just as it has got control over other banks, constituting the modern market. Relation between several units also, it may be said, leaves a good deal which is desired for.

Two sides.

Control of indigenous bankers essentials.

Relation between units.

(2) **Absence of a bill market.** Next there is an absence of a bill market in the country. In fact, it is due to a limited use of bills and this

Limited use of bills due to various causes.

because of a number of causes. First of all, banks in India prefer investment in government securities. Secondly, it is difficult to distinguish between a finance bill and a trade bill. Thirdly, cash credit is more popular with Indian banks. Fourthly, sometimes back, stamp duties on bills were also very heavy. Fifthly, bills are written in a foreign language. Hundis, on the other hand, suffer from their complex phraseology and vague rules. Sixthly, bills arising out of foreign trade transactions are drawn in sterling and hence discounted in London and not in India. Finally, bills are not used in this country also in connection with agriculture.

(3) **Absence of confidence in Indian currency unit.** Thirdly, India has got a token currency which is inconvertible for inland purposes, and hence people have no confidence in it. They like to keep their savings in bullion and other properties.

Token currency.

(4) **Absence of confidence in banks.** Absence of confidence in banks may be permanent or only at times of distress. In Western countries, it is limited only to the times of distress. In India, it is, however, both. Permanent absence of confidence is due to repeated bank failures, and absence of confidence at times is due to the lack of assistance to them in times of need, unbalanced press and public opinion and actions of banks themselves.

Failure of banks.

(5) **Neglect of other branches of banking.** Indian bankers have neglected such branches of banking as exchange and industrial. They must pay attention towards these as well.

Absence of exchange and industrial banking.

(6) **Whole sale imitation of English sys-**

Foreign characteristic.

tem. There has been a wholesale imitation of English system in the parlour of banking with the result that Indian ideal of simplicity in all spheres of life have been jettisoned this sphere.

Foreign language.

(7) **Use of foreign language.** Banks in this country use English language. We know that many of our people are not even literate what to say of their being conversant with English. Under the circumstances, they find it very difficult to deal with them. The use of English language necessitating the appointment of only English people and their number being very small, the scope for selection of the members of the staff is also very much narrowed.

Foreigners can't solve our problems.

(8) **Foreign domination.** Indian banking system is dominated by non-Indians, whose real sympathies and interests cannot be with India. Their only aim is to earn profit and exploit the people of this country. They have, in fact, failed to inspire confidence and solve Indian problems. They have also not been successful to establish a closer relation with the people which is very necessary from all points of view.

Poverty.

(9) **Low level of the income of the people.** The level of the income of the people being very low in this country, they cannot be expected to save anything and deposit in the banks. No other single cause is perhaps more responsible for the slow growth of banking habit in this country than this one is.

Absence of training.

(10) **Lack of training in banking.** Trained Indians both in theory and practice of banking are not available. Until the end of the nineteenth century, commercial and banking education had been completely non-existent in this

country. For a few decades arrangements have, however, been made for it, but advantage is not being taken of the facility so far provided to any appreciable extent.

(11) **Absence of a banking law.** There is no separate banking law in India. The Indian Joint Stock Companies Act applies to banking as well. Proposals have, however, been made by the Reserve Bank of India to remedy the evil. Let us hope that this will be done soon.

No banking law.

(12) **Absence of a Bankers' Association.** There is no Bankers' Association in this country to discuss matters of common interest and co-ordinate the activities of different institutions. Its usefulness in alloying panic can also not be disputed, and the need for its establishment is the greatest in this country for this reason if not for others.

No Bankers' Association.

APPENDIX

SUPPLEMENTARY QUESTION

Q. 1. Briefly describe the nature and the function of the Indian money market. (*Rajputana*)

A. Please consult answers to previous Qs. in this chapter.

CHAPTER XXVI

MISCELLANEOUS

Q. 199. Discuss the reasons for the lack of development of a bill market in India.

(Allahabad, 1943)

A. **Reasons for the lack of development of a bill market in India.** The reasons for the lack of development of a bill market in India are as follows :—

Bankers' preference of investment in Govt. securities due to various causes.

(1) Bankers in India prefer investment in government securities. Prior to the establishment of the Reserve Bank of India, they were not sure whether Imperial Bank would rediscount their hundis. In fact, it had not laid down any standard, and used to refuse accommodation on the plea of the particular hundi or hundis not being up to the standard. The banks themselves also preferred obtaining loans from the Imperial Bank on the security of government papers over rediscounting of their hundis as the latter step meant the disclosure of the names of their clients to an institution which acted as a rival to them, and surely this they could not like. Besides, even if the Imperial Bank refused to grant loans on the security of the government papers, or they themselves did not like to approach it, these could be easily realised in the open market. No doubt, these difficulties have been removed because of the establishment of the Reserve Bank. But the old practice continues. This is more so because the Reserve Bank charges the same

rate for rediscounting as well as for granting accommodation on the security of government papers. It can bring about a change in the situation by charging a slightly higher rate for granting loans than for rediscounting. Bank rate should, in fact, be applied here only to the rediscounting of hundis and not to the granting of accommodation.

R. B. should charge different rates for discounting and giving loans.

Another reason for the popularity of government papers was their yield. This has, however, now caused to be so.

Yield of Govt. papers higher.

(2) It has been found difficult to distinguish between finance bills and trade bills in the absence of the documents of title to goods. In fact, there ought to be warehouses, and sales should be effected by means of the transfer of the warehouse receipts which may act as evidences of trade transactions in connection with which bills arise, and thus facilitate the distinction between trade and finance bills.

No distinction between finance and trade bills.

(3) The scarcity of bills is also due to wide prevalence of the system of cash credit which is advantageous to the borrowers as well as the lending banks. Bills, however, should be preferred by both because of its obvious advantages, and this is sure to happen as they are realised by them.

Wide prevalence of cash credit system.

(4) Previously bills were unpopular also due to heavy stamp duties. They have, of course, been reduced now.

Stamp duties.

(5) Bills are of foreign origin, and cannot be very popular because of the use of foreign language which very few people know. Hundis have, however, been in use in India since ancient,

Use of foreign language in bills.

Defective phraseology of hundis and absence of any islation.

times, and are written in almost all the Indian languages. But there is the difficulty of its phraseology which is very complex and difficult to be memorised. It should, in fact, be simplified. Moreover, they are governed by the negotiable Instrument Act subject to the local customs and usages which differ very widely. They should now be unified and if possible legalised.

Encouragement to the drawing up of rupee bills essential.

(6) Bills arising out of foreign trade transactions are mostly drawn in terms of sterling. In case, they are drawn in terms of internal currency, they will surely lead to the building up of a bill market.

Absence of Bill Accepting Houses.

(7) There is a complete absence of bills accepting houses in this country on the lines of those in England. Bankers also do not act as acceptors of bills on behalf of their customers to any appreciable extent. Its development is sure to prove very useful in building up a bill market in India.

Emergence of agricultural bills necessary.

(8) Bills are also not used in this country in connection with the agricultural industry. Anticipatory bills, as they are called, are in very much use in America, and they can be introduced in India as well with much advantage. Co-operative godown societies may be formed and cultivators may be encouraged to obtain advances on harvested produce by joining them and allowing them to draw usance bills on themselves (cultivators). The societies may, then, discount them with district co-operative institutions and the latter in turn with the joint stock banks or Reserve Bank. The indigenous bankers and money-lenders may also use the bills

in making advances to the cultivators in the same way as co-operative societies.

Q. 200. Attempt a lucid essay on the present system of rural credit in India.

(*Calcutta*, *1940*)

A. **A lucid essay on the present system of rural credit in India.** The present system of rural credit in India is, of course, very complex. First of all, since 1935, there is the Reserve Bank of India which is authorised to grant loans for periods not exceeding ninety days and rediscount promissory notes of certain agencies not maturing after a period of more than nine months. Loans for ninety days, as we know, cannot help the agriculturists. Provincial co-operative banks and central land mortgage banks to whom they are allowed can, however, take them to meet a temporary shortage. Besides, the process of making credit available to the agriculturists being very lengthy, they cannot take its advantage. It should be made available to central co-operative banks directly rather than through the provincial banks. In connection with the rediscounting facilities, there is also a mention of the notes of the warehousing societies which must be established by the Reserve Bank.

Reserve Bank.

Defective provisions.

Next, there are the Imperial Bank of India and other commercial banks. The former provides the provincial banks and central banks with cash credits and overdrafts on the security of the promissory notes of the central banks in the former and primary societies in the latter case. It has, however, been reducing such advances in recent years as the promissory notes being backed by land are not regarded to be a good form of

I. B. and other commercial banks.

Defective practices.

security. It finances agriculture to some extent through the indigenous bankers as well who sometimes discount their hundis with it or obtain advances on the pledge of the produce. In the term other commercial banks are included the joint stock banks of the country. They carry on almost the same business as the Imperial Bank. Some of them also make advances to land-lords on the security of their landed property.

Credit co-operative societies.

The best agency for financing the short-term needs of the farmers, however, consists of credit co-operative societies. The Raiffeisen type is meant for financing agriculture exclusively. It is a voluntary association of the villagers themselves formed with a view to give mutual help. Liability of each member is limited. The society obtains funds from deposits, entrance fees and sometimes contribution of capital from the members, and borrowings, and these are advanced to members according to their means and requirements. Their management is mostly honorary, except the clerical staff which is on paid salary. By common consent, the more intelligent from amongst the members are allowed to carry on the chief executive and superintending work. The credit co-operative movement in India embraces (*a*) primary credit co-operative societies, (*b*) central co-operative banks, and (*c*) provincial co-operative banks, at present. There is also the possibility of an Apex All-India Co-operative Bank, though it has not been started so far. Primary credit co-operative societies are the societies in the villages. Central co-operative banks are mostly located in district head-quarters. The function of these banks is not only to supply the required capital to the primary societies but also to make the

Their characteristic organisation.

Functions.

surplus resources of some societies available to other societies suffering from a deficiency of funds and to provide proper guidance and inspection over them. They are formed of primary societies and individual members as well and draw funds from share capital, reserve deposits and loans. Provincial co-operative banks are found at present in India in all the major provinces except the United Provinces* and some of the states. In a large majority of them, the constitution is a mixed one, that is, both in the general body of the banks and in the directorate, there are individual shareholders as well as representatives of co-operative societies and central banks. Their working capital is derived from shares, reserve and other funds, deposits and loans from individuals, societies, provincial and central banks and Government. The movement suffers from various defects which must be removed.

Constitution of provincial banks.

Working capital.

Just as co-operative societies provide the best form of agency for supplying short term credit to the agriculturists, land mortgage banks provide the best form of agency for supplying long term credit to them. There are three main types of such banks, (*i*) those of strictly co-operative type, (*ii*) those of commercial type, and (*iii*) those of quasi-co-operative type. A land mortgage bank of strictly co-operative type is an association of borrowers who raise credit by the issue of mortgage bonds bearing interest and made payable to bearer. The commercial type has a share capital, works for profit and declares dividend. A quasi-co-operative type of bank has a mixed membership of borrowers and non-borrowers, operating over fairly large areas

Land mortgage banks

Their classification.

*U. P. co-operative bank is going to be started soon.

and formed with share capital and on a limited liability basis. The number of land mortgage banks as well is not sufficient to cope with the requirements. Moreover they too suffer from certain serious defects which must be removed.

Number very small.

The above agencies, however, belong to the class of modern banks, and are taking up the work of providing rural credit gradually. But there are money-lenders and indigenous bankers also who have been rendering this service in this country from times immemorial. In fact they have been playing for long a very important part, and cannot be ousted out easily. Their popularity is due to their simple methods of business, personal touch with the borrowers, local knowledge and experience. They have, however, been hit very hard in recent years due to the general economic depression, the protection given to the agriculturist borrowers, the growth of co-operative societies, the delay in the matter of awarding decrees, and the suspicion against the questionable practices of some of them. But steps are being taken to improve them and there is every possibility of their becoming more useful in near future.

Money-lenders and indigenous bankers.

Causes of their popularity.

Present difficulties.

They take a lion's share at present in financing the production and marketing of agricultural produce. They usually give loans for current agricultural requirements which include expenses of cultivation and the household, payment of rent or land revenue, etc., on personal security on the understanding that the harvest is to be sold to or through them, or on the mortgage of crops. But when the loans are large or given for a long period, security in the shape of mortgages of

Services rendered by them.

land, houses or ornaments has to be supplied to them. They make no enquiries regarding the objects for which loans are demanded. The loans are given in cash as well as in kind. Interest is added to the principal at short intervals, so that this form of compound interest rapidly increases the principal to a large amount. Those living in towns finance them on condition that they would send the produce received by them from their clients to them, and thus finance marketing. They provide remittance and storage facilities as well.

Their methods.

Takavi loans of the Govt.

In the end, it may be said that the Government also finances them in the form of what are known as Taqavi loans which are both short term and long term. Its distribution is much appreciated whenever a calamity occurs, but in ordinary times the cultivator prefers to borrow from the money-lender than from the Government, in spite of his higher rate of interest. This is due to the defects in its distribution which can surely be improved if the help of co-operative societies is taken.

Q. 201. Suppose you want to send a remittance of Rs. 1,000 to Calcutta from Lucknow. In what different ways can you remit the money ? (1931)

Money order,

A. **Different ways for remitting the money in question.** There are different ways of remitting this money from Lucknow to Calcutta or from any one town to another in this country. First of all, we have post-offices doing remittance business. We may fill up a money-order form. But, as not more than Rs. 600 can be sent by one money-order, two money-order

forms shall have to be filled in this case. The commission charged by the post-office shall amount to Rs. 10. This is really too much and hence we will not like to adopt this means.

Registered and Insurance covers.

Money can also be sent through post-offices under registered and insured covers. We may take a thousand-rupee note or ten one-hundred rupee notes for this purpose. The charges for sending a registered insured cover containing notes worth this sum will be something about Rs. 1-9-0.

Telegraphic money order.

In case, we want immediate payment we may also send a telegraphic money-order for which the charges will be the same as those for an ordinary money-order with the only difference that a small fee of annas 9 shall have to be paid in addition for the use of a telegram by the post-office.

Money orders by Air Mails.

Money-orders can also be sent by Air-mail Service provided it is available between two such towns.

Hundi.

There are indigenous bankers doing hundi business in different towns of the country. One of them may be approached with the sum to be transferred. He will, on receipt of a small sum by way of his commission, issue a hundi on some Calcutta merchant. This hundi may be sent under a postal cover to the payee who shall be able to obtain the payment from the Calcutta merchant named in the hundi on presentation of the same.

Bank Drafts.

The most popular method adopted by the people these days is, however, to approach a modern banker for the issue of a bank draft. It charges a small commission depending upon the competition of other modern bankers. Usual rate of commission is annas 4 per cent but it

will be much lower for Rs. 1,000 and between such big towns as Lucknow and Calcutta, where there are several offices doing this business. A bank draft is also sent and realised in the same way as a hundi. The bankers also issue telegraphic transfers if it is so desired by the remitter. T. T.

Q. 202. Are the existing banking facilities in the U. P. adequate for the needs of the province? If not what is to be done to make them adequate? (1933)

A. **Existing Banking facilities in the U. P. and suggestions for their improvement.** The existing banking facilities in the U. P. are provided for by the money-lenders and indigenous bankers, the co-operative societies, the Post Offices, the Indian joint stock banks, the foreign exchange banks, the Imperial Bank and the Reserve Bank. Of these, the money-lenders and indigenous bankers are the most important. They are spread all over the province and finance the whole of its agricultural trade and industry. If modern banks have any hand in the same, it is through them and not directly. It is said that these money-lenders and indigenous bankers are a set of wicked people. But in fact, this is not so. The indigenous bankers as a class are perhaps the most honest people. An average man prefers depositing with one of them over that with even the Imperial Bank. Some of the money-lenders may be oppressive, but all should not be judged by the same standard. Besides financing the whole of the agricultural trade and industry, they also finance the cottage industry and other kinds of trade. Some of the large-

Their names.

Money-lenders and indigenous bankers.

Truth about them.

Their usefulness.

perial Bank of India acts at other places as it agent.

APPENDIX

SUPPLEMENTARY QUESTION

Q. 1. What are the causes of the unpopularity of bills in India ? Suggest measure to make them popular.

A. Please consult answer to Q. 200.

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